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State-Defined Marital Status: Its Future as an Operative Tax Factor

Daniel J. Lathrope*

Certainly the tax-minded young man and woman, whose relative incomes place them in the disfavored group, will seriously consider cohabitation without marriage. Thereby they can enjoy the blessings of love while minimizing their forced contribution to the federal fisc. They can synthesize the forces of love and selfishness.¹

INTRODUCTION

Marital status has a significant impact upon an individual's federal income tax liability.² Filing status, personal exemptions, exclusions, deductions, and tax credits are affected by whether a taxpayer is single or married.³ The economic relationship between married individuals has been the basis for the role marital status plays as an operative tax factor.⁴ For example, since most married couples operate as a single eco-

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¹ *Mapes v. United States*, 576 F.2d 896, 898 (Ct. Cl.), cert. denied, 439 U.S. 1046 (1978).

² Marital status also plays a significant role in the operation of the federal estate and gift taxes. *E.g.*, I.R.C. § 2040 (estate tax consequences of qualified joint interests); I.R.C. § 2056 (estate tax marital deduction); I.R.C. § 2523 (gift tax marital deduction). The observations and conclusions in this Article concerning the interrelationship between the federal income tax and state-defined marital status are equally applicable to the federal estate and gift taxes. For a discussion of possible estate and gift tax savings from marriage or a "marriage in contemplation of death," see Wenig, *Marital Status and Taxes* 241-47 in G. DOUTHWAITE, *UNMARRIED COUPLES AND THE LAW* (1979).

³ STAFF OF JOINT COMM. ON TAXATION, 96TH CONG., 2D SESS., *THE INCOME TAX TREATMENT OF MARRIED COUPLES AND SINGLE PERSONS* 8-15 (Comm. Print 1980) [hereafter 1980 JOINT COMM. PRINT]. It has been estimated that more than 40 sections of the Internal Revenue Code are affected by marital status. G. DOUTHWAITE, *supra* note 2, at 191 & n.6.

⁴ See Bittker, *Federal Income Taxation and the Family*, 27 STAN. L. REV. 1389, 1392-95 (1975); McIntyre, *Individual Filing in the Personal Income Tax: Prolegomena to Future Discussion*, 58 N.C.L. REV. 469, 469-71 (1980). The Supreme

nomonic unit, the income tax treats spouses as a single taxpaying unit whose tax liability is dependent upon its total taxable income.⁵ The Internal Revenue Code (Code) also recognizes spouses' near identity of interest when dealing with one another and subjects intramarital transactions to special scrutiny.⁶ Attribution rules frequently require taxpayers to be treated as the constructive owners of interests owned by their spouses when determining the tax consequences of transactions.⁷

Court, in applying the predecessor of I.R.C. § 267 to disallow losses reported by a married couple, noted:

Section 24(b) states an absolute prohibition — not a presumption — against the allowance of losses on any sales between the members of certain designated groups. The one common characteristic of these groups is that their members, although distinct legal entities, generally have a near-identity of economic interests. It is a fair inference that even legally genuine intra-group transfers were not thought to result, usually, in economically genuine realization of loss, and accordingly that Congress did not deem them to be appropriate occasions for the allowance of deductions.

McWilliams v. Commissioner, 331 U.S. 694, 699 (1947) (footnote omitted).

⁵ Married taxpayers are generally permitted to file joint returns in which they aggregate their income, gains, losses, deductions, and credits. I.R.C. § 6013. Although married couples may elect to file separately, the rate tables are structured so that separate filing almost always results in increased tax liability. The rates applied to married taxpayers filing separate returns are the same as the rates applied to married taxpayers filing jointly with exactly twice as much taxable income. In 1983, a married taxpayer filing separately with \$30,000 of taxable income will pay \$8,007 of tax and will reach the 44% marginal tax rate. A married couple filing jointly in the same year with \$60,000 of taxable income will pay \$16,014 of tax and also will reach the 44% marginal bracket. I.R.C. § 1(a), (d). Joint filing allows a married couple to split, in effect, their total income and obtain the benefit of lower marginal tax rates. As a result, it is estimated that only 1.3% of married couples file separately. Couples who file separately often do so for reasons of privacy, because the relationship has broken down, or to avoid joint and several liability with respect to the return. 1980 JOINT COMM. PRINT, *supra* note 3, at 9, 48.

⁶ *E.g.*, I.R.C. § 267(a), (b)(1), (c)(4) (disallowance of losses from sales or exchanges and deductions for unpaid expenses and interest between taxpayers and their spouses); I.R.C. § 453(e), (f)(1) (elimination of the benefits of the installment method for sales between taxpayers and their spouses if the spouse disposes of the property before the taxpayer receives all payments attributable to the original sale); I.R.C. § 1239(a), (b)(1) (characterization of gain as ordinary income in the case of sales or exchanges of property between spouses if the property is depreciable in the hands of the transferee).

⁷ For example, shareholders are frequently considered to own their spouses' stock in a corporation for purposes of determining the tax consequences of transactions between shareholders and the corporation. *E.g.*, I.R.C. § 267(a), (b)(2), (c)(4) (attribution for purposes of disallowing losses on sales or exchanges and deductions for unpaid expenses and interest between an individual and a corporation more than 50% in value owned by the individual); I.R.C. § 318(a)(1) (attribution for purposes of provisions in subchapter C of the Code which expressly make § 318 applicable); I.R.C. § 341(e)

Marital status, however, is both overinclusive and underinclusive as an indicator of economic circumstances.⁸ Married couples may separate or spouses may choose to arrange their relationship in a manner which retains their economic independence. Also, other family and nonmarital relationships may embrace financial and economic ties similar to those in marriage. The Code acknowledges the community of interest which exists in many nonmarital familial relationships. Reduced tax rates are provided for single taxpayers with familial or quasi-familial obligations and attribution rules frequently require that a taxpayer be deemed the owner of interests owned by various relatives.⁹ However, tax distinc-

(attribution for purposes of testing certain exceptions to classification of a corporation as "collapsible"); I.R.C. § 544(a)(2) (attribution for purposes of testing whether a corporation is a personal holding company). Also, partners are considered to own their spouses' interests in partnership capital or profits when determining the tax results of transactions between the partner and the partnership. I.R.C. § 707(b)(3).

There is a split of authority concerning whether attribution may be disregarded when there is evidence of actual family hostility. Compare *Robin Haft Trust v. Commissioner*, 510 F.2d 43 (1st Cir. 1975) (family discord may preclude rigid application of the § 318 attribution rules in determining whether a redemption qualifies as an exchange under § 302(b)(1)), *vacating and remanding* 62 T.C. 145 (1974) with *Niedermeyer v. Commissioner*, 62 T.C. 280 (1974) (attribution under § 318 for § 304 purposes is not affected by family hostility), *aff'd per curiam*, 535 F.2d 500 (9th Cir.), *cert. denied*, 429 U.S. 1000 (1976); *David Metzger Trust v. Commissioner*, 76 T.C. 42 (1981) (in dictum, a majority of the Tax Court indicated that family hostility may be considered in applying § 302(b)(1) if there is some reduction in the redeemed shareholder's actual and constructive ownership interest in the corporation), *aff'd*, 693 F.2d 459 (5th Cir. 1982) (Fifth Circuit rejected the view that family hostility may mitigate attribution), *cert. denied*, 103 S. Ct. 3537 (1983); *David Miller v. Commissioner*, 75 T.C. 182 (1980) (family hostility has no effect on the application of the § 267 attribution rules); Rev. Rul. 80-26, 1980-1 C.B. 66 (the I.R.S. will not follow the First Circuit's decision in *Robin Haft Trust*).

⁸ Constitutional challenges to marriage-based tax distinctions have, however, been unsuccessful. The marriage penalty has been sustained against various constitutional challenges. *Druker v. Commissioner*, 697 F.2d 46 (2d Cir. 1982), *cert. denied*, 103 S. Ct. 2429 (1983); *Johnson v. United States*, 422 F. Supp. 958 (N.D. Ind. 1976), *aff'd per curiam sub nom. Barter v. United States*, 550 F.2d 1239 (7th Cir. 1977), *cert. denied*, 434 U.S. 1012 (1978); *Mapes v. United States*, 576 F.2d 896 (Ct. Cl.), *cert. denied*, 439 U.S. 1046 (1978). Also, constitutional challenges to the lower rates provided in § 1 for married taxpayers have been rejected. *Faraco v. Commissioner*, 261 F.2d 387 (4th Cir. 1958), *cert. denied*, 359 U.S. 925 (1959); *Kellems v. Commissioner*, 58 T.C. 556 (1972), *aff'd per curiam*, 474 F.2d 1399 (2d Cir.), *cert. denied*, 414 U.S. 831 (1973).

⁹ The Code permits a head of household to use rate tables that are more favorable than those applicable to other single taxpayers. Compare I.R.C. § 1(b) with I.R.C. § 1(c). To qualify as a "head of household," a taxpayer must be single (not a surviving spouse) and either (1) maintain as the taxpayer's home a household which constitutes

tions based upon family relationships, such as marriage, are applied with rigidity. The economic sharing which may exist in quasi-marital relationships is ignored. While total marital breakdowns may have tax significance, married taxpayers who are living apart or who maintain their economic independence are still married for tax purposes.¹⁰

Federal tax law does not define marital status. Instead the tax law, in a majority of situations, defers to local law determinations of marital status,¹¹ recognizing the substantial interests and expertise of the states

the principal place of abode for an individual who is either a designated family member or a dependent of the taxpayer for whom the taxpayer is entitled to a deduction under § 151 of the Code, or (2) maintain a household which is the principal abode of one of the taxpayer's parents if the taxpayer is entitled to a deduction under § 151 for that parent. I.R.C. § 2(b). Also, the Code's attribution rules recognize the community of interest in many familial relationships. *E.g.*, I.R.C. § 267(c)(4) (attribution to the taxpayer of interests owned by spouses, brothers, sisters, ancestors, and lineal descendants); I.R.C. § 318(a)(1) (attribution to the taxpayer from children, grandchildren, and parents); I.R.C. § 707(b)(3) (adopting the family attribution rules in § 267(c) of the Code for purposes of determining the tax consequences of certain transactions between a partner and a partnership or between two commonly controlled partnerships).

¹⁰ Married taxpayers who are legally separated under a decree of divorce or of separate maintenance are not considered married for tax purposes. *E.g.*, I.R.C. §§ 143(a)(2), 6013(d)(2). Additionally, for purposes of filing a head of household return and determining personal exemptions, individuals are considered single if an individual is (1) married, (2) files a separate return, (3) maintains as the individual's home a household which constitutes the principal place of abode for more than one-half of the year of a dependent child or stepchild, (4) furnishes over one-half of the cost of maintaining the household during the year, and (5) during the entire year the individual's spouse is not a member of the household. I.R.C. §§ 2(c), 143(b). Section 44A, which allows a credit for certain household and dependent care services necessary for gainful employment, adopts a standard similar to § 143(b) to permit a married taxpayer to claim the credit despite filing separately. I.R.C. § 44A(f)(4). The credit for the elderly may be claimed by a married taxpayer even though a joint return was not filed if the couple lived apart at all times during the taxable year. I.R.C. § 37(d)(1).

¹¹ *E.g.*, *Dunn v. Commissioner*, 70 T.C. 361 (1978) (temporary order for support by Wisconsin court did not constitute a legal separation under § 143(a)(2), so the taxpayer was still married and could not file as a single person), *aff'd*, 607 F.2d 995 (2d Cir. 1979); *Estate of Goldwater v. Commissioner*, 64 T.C. 540 (1975) (New York declaratory judgment validating prior Mexican divorce recognized for purposes of determining who qualified as a surviving spouse in applying the estate tax marital deduction), *aff'd*, 539 F.2d 878 (2d Cir.), *cert. denied sub nom.* *Lipkowitz v. Commissioner*, 429 U.S. 1023 (1976); *see also* B. BITTKER, *FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS* ¶ 111.3.6 (1981) [hereafter *FEDERAL TAXATION*]. *But see* *Estate of Borax v. Commissioner*, 349 F.2d 666 (2d Cir. 1965) (court adopted a rule of validation to recognize a Mexican divorce for tax purposes despite a declaration by a New York court that the prior divorce was invalid), *cert. denied*, 383 U.S. 935 (1966); *Feinberg v. Commissioner*, 198 F.2d 260 (3d Cir. 1952) (payments made by a husband to his wife were deductible alimony although a New York court declared the Florida divorce ob-

in domestic relations matters.¹² Typically, if taxpayers are considered married under state law, they will be considered married for federal income tax purposes.

Many states, however, are reducing the role they play in the regulation of marital status.¹³ The legal effects of formal marriage have been reduced by a variety of factors,¹⁴ and the trend is toward permitting couples greater freedom in structuring their marriages.¹⁵ Concurrently, relationships other than formal marriage are gaining increasing social

tained by the husband a nullity).

¹² See *Boyter v. Commissioner*, 74 T.C. 989, 994 (1980) (concluding that since Maryland would not recognize divorces obtained in Haiti and the Dominican Republic the divorces had no effect for tax purposes), *remanded*, 668 F.2d 1382 (4th Cir. 1981); *Eccles v. Commissioner*, 19 T.C. 1049, 1051 (interlocutory decree of divorce which did not constitute a decree for separate maintenance did not end the matrimonial status of the parties until the lapse of six months, so the taxpayer could file a joint return with his wife), *aff'd per curiam*, 208 F.2d 796 (4th Cir. 1953).

¹³ Recognition of marriage as a fundamental right has led courts to strike down state regulations concerning marriage. *E.g.*, *Zablocki v. Redhail*, 434 U.S. 374 (1978) (invalidating a Wisconsin statute requiring residents with support obligations to minors to provide proof of compliance with the support obligation and to demonstrate that children covered by the support order are not likely to become "public charges" to obtain a marriage license); *Loving v. Virginia*, 388 U.S. 1 (1967) (striking down Virginia's miscegenation laws); see also *In re Carrafa*, 77 Cal. App. 3d 788, 143 Cal. Rptr. 848 (3d Dist. 1978) (overruling a Department of Corrections decision denying a prison inmate's petition to marry).

Professors Weyrauch and Katz have identified increased emphasis on personal rights and privacy and movement toward a system of government entitlements as factors resulting in decreased judicial and legislative regulation of marriage. W. WEYRAUCH & S. KATZ, *AMERICAN FAMILY LAW IN TRANSITION* 350-52 (1983).

¹⁴ Professor Glendon has identified the following factors as diminishing the legal effects of formal marriage: (1) constitutional trends recognizing the right to marry and right to privacy; (2) increased equality and autonomy of spouses; (3) the trend toward no-fault divorce laws; and (4) recent trends in spousal maintenance after divorce. Glendon, *Marriage and the State: The Withering Away of Marriage*, 62 VA. L. REV. 663, 664-67, 684, 697-711 (1976). Professor Clark has concluded that the law appears to be in the process of redefining marriage and has suggested:

The result seems to be that contemporary marriage cannot be legally defined any more precisely than as some sort of relationship between two individuals, of indeterminate duration, involving some kind of sexual conduct, entailing vague mutual property and support obligations, that may be formed by consent of both parties and dissolved at the will of either.

Clark, *The New Marriage*, 12 WILLAMETTE L.J. 441, 450-51 (1975) (footnote omitted).

¹⁵ See Prager, *Sharing Principles and the Future of Marital Property Law*, 25 UCLA L. REV. 1, 15-16 (1977); Shultz, *Contractual Ordering of Marriage: A New Model For State Policy*, 70 CALIF. L. REV. 204 (1982); Weitzman, *Legal Regulation of Marriage: Tradition and Change*, 62 CALIF. L. REV. 1169, 1249-88 (1974).

acceptance.¹⁶ Courts have adopted quasi-marital theories for determining the rights and obligations of nonmarital cohabitants.¹⁷ Thus, the

¹⁶ In 1980 there were 1,560,000 households in the United States occupied by two unrelated adults of the opposite sex. This was nearly three times the number of unmarried couple households in 1970. The partners were frequently in the same age group, suggesting that many of these households represent quasi-marital relationships. Less than one percent of the 1980 unmarried couple households had a person 65 years of age or older sharing living quarters with an unrelated person of the opposite sex who was under the age of 35. UNITED STATES BUREAU OF THE CENSUS, CURRENT POPULATION REPORTS, SERIES P-20, NO. 365, MARITAL STATUS AND LIVING ARRANGEMENTS: MARCH 1980 4-5. For additional analysis of the increasing number of nonmarital relationships, see Wolk, *Federal Tax Consequences of Wealth Transfers Between Unmarried Cohabitants*, 27 UCLA L. REV. 1240, 1240 n.1 (1980).

¹⁷ See *Marvin v. Marvin*, 18 Cal. 3d 660, 557 P.2d 106, 134 Cal. Rptr. 815 (1976); *Carlson v. Olson*, 256 N.W.2d 249 (Minn. 1977); *Estate of Thornton*, 81 Wash. 2d 72, 499 P.2d 864 (1972); see generally Bruch, *Property Rights of De Facto Spouses Including Thoughts on the Value of Homemakers' Services*, 10 FAM. L.Q. 101 (1976); Casad, *Unmarried Couples and Unjust Enrichment: From Status to Contract and Back Again?*, 77 MICH. L. REV. 47 (1978); Folberg & Buren, *Domestic Partnership: A Proposal for Dividing the Property of Unmarried Families*, 12 WILLAMETTE L.J. 453 (1976); Kay & Amyx, *Marvin v. Marvin: Preserving the Options*, 65 CALIF. L. REV. 937 (1977); Prager, *supra* note 15, at 19-22; Comment, *Property Rights Upon Termination of Unmarried Cohabitation: Marvin v. Marvin*, 90 HARV. L. REV. 1708 (1977); Note, *Property Rights Between Unmarried Cohabitants*, 50 IND. L. REV. 389 (1975); Note, *Beyond Marvin: A Proposal for Quasi-Spousal Support*, 30 STAN. L. REV. 359 (1978).

In *Estate of Thornton*, a woman who had lived with the decedent for 16 years, during which time they had four children, alleged the existence of a partnership interest in the decedent's cattle ranch. The court reversed the grant of a motion to dismiss the claim, finding that the woman had presented a prima facie case of implied partnership. In the course of its opinion, the court suggested that the plaintiff might have asserted that her relationship with the decedent "created in her behalf a right similar to that of a legal wife in the community property of the spousal unit." 81 Wash. 2d at 77, 499 P.2d at 866.

The California Supreme Court made it clear in *Marvin* that it was not holding that the parties were "married," or extending the rights of valid or putative spouses to cohabitants. 18 Cal. 3d at 684 n.24, 557 P.2d at 122 n.24, 134 Cal. Rptr. at 831 n.24. However, the court also stated that:

[A]lthough parties to a nonmarital relationship obviously cannot have based any expectations upon the belief that they were married, other expectations and equitable considerations remain. The parties may well expect that property will be divided in accord with the parties' own tacit understanding and that in the absence of such understanding the courts will fairly apportion property accumulated through mutual effort. *Id.* at 682, 557 P.2d at 121, 134 Cal. Rptr. at 830 (emphasis added).

In *Carlson v. Olson*, the plaintiff brought an action to partition real and personal property accumulated during the 21 years she and the defendant lived together. The court affirmed the award of a one-half interest in the property to the plaintiff. Based

traditional interest of the states in defining and preserving the legal structure of marriage appears to be waning, while informal "marriages" are becoming more common. As a result, marriage is becoming indistinguishable from many less formal relationships.

Recently, the federal income tax has been faced with developments which are undoubtedly related in some degree to the shift in societal and judicial views concerning marriage: individuals have attempted to realize the potential tax benefits derived from shifts in marital status. Temporary divorces have been undertaken for tax reasons and temporary marriages have been suggested as a tax planning strategy for the unmarried.¹⁸

The blurring of definitional and functional boundaries between marital and nonmarital relationships, social acceptance of relationships outside of formal marriage, and a willingness on the part of some taxpayers to effect tax motivated changes in marital status mandate a re-evaluation of the federal tax law's use of state-defined marital status as an operative tax factor. Marriage-based tax distinctions should be premised upon assumptions concerning the nature of marriage and its role in society. For tax distinctions to be rationally based upon marital status, marriage should be indicative of an economic relationship and should be its almost exclusive representative in society. The role of marital status in the tax law is undercut to the extent marriage practices vary from accepted norms, nonmarital relationships embody marital characteristics, or marital status may be manipulated. If these trends continue, state-defined marital status must play a reduced role in the income tax. New federal standards, designed to protect and promote tax policy, must be developed to replace or reinforce state-defined marital status as a taxing factor. Additionally, courts must be willing to abandon local law determinations of marital status and adopt more flexible analytical approaches when tax policy is threatened.

This Article will examine the role marital status plays in the federal income tax and the manner in which the tax law determines whether a taxpayer is single or married. Judicial and administrative reactions to tax-motivated shifts in marital status will also be analyzed and the in-

upon the evidence concerning the parties' relationship, the court held that the award was in accord with the reasonable expectations of the parties.

¹⁸ See *Boyter v. Commissioner*, 74 T.C. 989 (1980) (year-end divorces obtained in Haiti and the Dominican Republic to permit filing as single taxpayers), *remanded*, 668 F.2d 1382 (4th Cir. 1981); Rev. Rul. 76-255, 1976-2 C.B. 40 (situation 2: year-end foreign divorce obtained to permit separate filing as single individuals); J. SONENBLICK, *THE LEGALITY OF LOVE* 158-61 (1981); Randall, *Tax Status of Friendly, But Unmarried, Taxpayers*, 57 TAXES 27, 32 (1979); Wenig, *supra* note 2, at § 5.11.

creasing weakness of state-defined marital status as a taxing factor will be demonstrated. Finally, this Article will explore potential alternatives and future developments.

I. MARITAL STATUS AND THE INCOME TAX

A. *The Code's Use of Marital Status*

There is no unifying thread of policy to explain the many tax distinctions resting upon marital status. The Code's use of marriage as a determinative tax factor is neither cohesive nor consistent. On occasion, spouses are a single taxable unit;¹⁹ in certain situations they may be viewed as separate entities;²⁰ in still other tax provisions a married couple may be treated as more than one but not quite two single taxpayers.²¹

For example, the Code, under certain circumstances, permits taxpayers to exclude dividends from gross income.²² However, the maximum allowable exclusion is \$100 for an individual, while spouses filing a joint return are allowed to exclude \$200 of dividends from income.²³ In another provision, the Code generally limits the amount of ordinary income against which capital losses may be deducted to \$3,000 for both a single person and a married couple.²⁴ Thus, if A receives \$50 of dividends and recognizes \$2,500 of short-term capital losses during 1983,

¹⁹ *E.g.*, I.R.C. § 121(b)(1) (providing that a married couple filing jointly and a single taxpayer are entitled to a one-time exclusion of \$125,000 of gain from the sale of a principal residence after attaining age 55); I.R.C. § 163(d)(1)(A) (limiting the amount of investment interest a married couple filing jointly may deduct to the amount available to a single taxpayer); I.R.C. § 165(h)(2) (treating a married couple filing jointly as one individual for purposes of the \$100 and 10% limitations on deductions of casualty losses).

²⁰ *E.g.*, I.R.C. § 44A(c)(1)(B) (imposing an earned income limitation equal to the lesser of the earned income of either spouse upon the employment related expenses of a married couple eligible for child care credit); I.R.C. § 219(f)(2) (requiring separate computation of qualified retirement contributions for each spouse without regard to community property laws).

²¹ *E.g.*, I.R.C. § 55(f)(1) (granting a married couple filing jointly a \$40,000 exemption amount for purposes of the alternative minimum tax while a single taxpayer obtains a \$30,000 exemption amount); I.R.C. § 63(d) (providing a \$3,400 zero bracket amount for a married couple filing jointly and a \$2,300 zero bracket amount for a single taxpayer); see 1980 JOINT COMM. PRINT, *supra* note 3, at 3, 10-15. The only discernible policy in the Code's treatment of marriage is to discourage separate filing by married taxpayers. *Id.* at 9.

²² I.R.C. § 116.

²³ I.R.C. § 116(a)(2).

²⁴ I.R.C. § 1211(b).

and *B* receives \$150 of dividends and recognizes \$3,000 of short-term capital losses during that year, marriage would be a mixed tax blessing for *A* and *B*. If single, *A* and *B* could exclude a total of \$150 of dividends from income, whereas if they marry they would be allowed to exclude the full \$200 of dividends received during the year. However, marriage would adversely impact the amount of capital losses *A* and *B* could deduct; if single they could fully deduct their \$5,500 of short-term capital losses, but if they marry, *A* and *B* would be limited to a \$3,000 capital loss deduction for the year.²⁵

The tax law does not consistently favor any particular living arrangement. Rather, each individual's tax circumstances determine whether marriage will or will not produce tax benefits. At times, there may be a tax savings for the married individual;²⁶ at other times a married individual might avoid a tax penalty by obtaining a divorce.²⁷ Nor is the degree of benefit or detriment attached to marriage uniform; in certain Code provisions the bonus or penalty attached to marital status

²⁵ The excess \$2,500 of short-term capital loss would be treated as a short-term capital loss in the succeeding taxable year. I.R.C. § 1212(b)(1)(A).

²⁶ The most significant potential tax bonus from marriage is the income splitting effect of filing a joint return. When one member of a couple earns substantially more income than the other, they can reduce their total tax liability by marrying. See *infra* text accompanying note 88. Additionally, many tax benefit provisions provide married couples filing joint returns with twice as large a benefit as single taxpayers. This may permit the couple to deduct or exclude a greater amount than if the parties were single. For example, § 41 allows a credit equal to one-half of the political contributions made by the taxpayer during the taxable year. The credit is limited to \$50 for an individual and \$100 in the case of married taxpayers filing jointly. I.R.C. § 41(b). Thus, if *X* made a \$150 political contribution and *Y* made a \$50 political contribution, they would be allowed credits of \$50 and \$25, respectively, if they are single. If *X* and *Y* married, they would be allowed a \$100 credit. Therefore, marriage would result in a \$25 tax savings. Not surprisingly, unmarried taxpayers living together may be tempted to file jointly as a married couple to achieve tax savings. *E.g.*, *Davis v. Commissioner*, 23 T.C.M. 1099 (1964) (unmarried individuals not entitled to file a joint return); see also *In re Marriage of Cary*, 34 Cal. App. 3d 345, 348, 109 Cal. Rptr. 862, 863 (1st Dist. 1973) (unmarried couple lived together for over eight years and filed joint income tax returns).

²⁷ The most significant tax penalty resulting from marriage is the additional tax paid by two married individuals who earn relatively equal amounts of income. See *infra* text accompanying notes 86-87. There is also a tax penalty for marriage in those provisions which treat a married couple filing jointly as a single taxpayer. For example, § 163(d) generally limits a taxpayer's deduction for investment interest to \$10,000 plus the taxpayer's "net investment income." The \$10,000 limit applies to single taxpayers and married taxpayers filing jointly. Married taxpayers filing separately are subject to a \$5,000 limit. I.R.C. § 163(d)(1)(A). Thus, taxpayers with substantial amounts of investment interest could be disadvantaged by marriage.

is greater proportionately than in others.²⁸

Inconsistency in the treatment of marital status is largely the result of legislative indifference to marriage-based tax distinctions. Changes in Code provisions are frequently accompanied by unexplained changes in the treatment of married taxpayers. For example, prior to 1981 the \$100 exclusion for dividends was applied to each individual taxpayer, regardless of marital status.²⁹ Therefore, in 1980, *A* and *B* in the earlier example would have been entitled to exclude \$150 of dividends whether married or single if they did not jointly own stock. Also, for years prior to 1981, taxpayers were allowed additional first-year depreciation on qualifying property.³⁰ This benefit was limited to a total of \$10,000 of qualifying property for a single taxpayer, while married couples filing jointly were entitled to additional first-year depreciation

²⁸ Compare I.R.C. § 63(d) (two single individuals are entitled to \$1,200, or about 35%, more zero bracket amount than a married couple) with I.R.C. § 217(b)(3) (imposing identical dollar limits upon deductions of certain moving expenses by married couples filing jointly and single taxpayers) and I.R.C. § 37(b)(2), (c)(1) (two single individuals are entitled to \$1,250, or 33%, more credit base under the credit for the elderly than a married couple filing jointly if both spouses are eligible for the credit; for purposes of the adjusted gross income limitation, two single taxpayers are permitted \$5,000, or 50%, more base than a married couple filing jointly).

²⁹ Prior to 1981, § 116(a) provided:

EXCLUSION FROM GROSS INCOME. — Gross income does not include amounts received by an individual as dividends from domestic corporations, to the extent that the dividends do not exceed \$100. If the dividends received in a taxable year exceed \$100, the exclusion provided by the preceding sentence shall apply to the dividends first received in such year.

Internal Revenue Code of 1954, Pub. L. No. 591, § 116(a), 68A Stat. 3, 37, *amended* by Pub. L. No. 88-272, § 201(c), 78 Stat. 19, 32 (1964), and by Pub. L. No. 94-455, § 1901(a)(20), 90 Stat. 1525, 1766 (1976) "current version at I.R.C. § 116(a)".

The Crude Oil Windfall Profit Tax Act of 1980 amended § 116, effective for taxable years beginning after December 31, 1980, and before January 1, 1983, to make that section applicable to interest and to increase the amount of the exclusion to \$200 for an individual and \$400 in the case of a married couple filing jointly. Crude Oil Windfall Profit Tax Act of 1980, Pub. L. No. 96-223, § 404(a), (c), 94 Stat. 305-08 (1980). There was no explanation for the change in treatment of married taxpayers. H.R. REP. No. 817, 96th Cong., 2d Sess. 156-58 (1980).

The Economic Recovery Tax Act of 1981 repealed the \$200/\$400 interest and dividend exclusion for taxable years beginning after 1981 and replaced it with the present version of § 116 which provides a \$100 (\$200 in the case of joint returns) exclusion for dividends received from a domestic corporation. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 302(b)(2), 95 Stat. 272 (1981).

³⁰ Pub. L. No. 85-866, § 204(b), 72 Stat. 1679 (1958) (current version at I.R.C. § 179).

on \$20,000 of property.³¹ As part of the Economic Recovery Tax Act of 1981, Congress repealed the allowance for additional first-year depreciation and replaced it with a provision permitting taxpayers to elect to expense the cost of qualifying property.³² The aggregate amount of property subject to the expense election in 1983 is \$5,000 for a single taxpayer and married taxpayers filing jointly, while married taxpayers filing separate returns are each allowed to expense a total of \$2,500 of property.³³ In changing the statute, Congress without explanation substantially reduced the benefits available for a married couple as compared to two single individuals.³⁴

B. Marital Status and Tax Rates

The absence of consistent themes within the Code does not compel the conclusion that all tax distinctions based upon marital status are unprincipled or lack policy justification. Extensive consideration has been devoted to the taxation of the family. There is ongoing debate among commentators concerning the relationship between family circumstances and the federal income tax, and significant legislative changes have been enacted to implement conscious policy decisions.³⁵

The relationship between marital status and tax rates has been particularly controversial. Tax theorists have thoroughly debated the extent to which marital relationships should affect an individual's tax liability. One group of theorists has advocated, based upon considerations of equity and efficiency, a marriage neutral tax system in which each individual's tax liability is determined separately under a single rate schedule.³⁶ Marital status, it is argued, is a personal decision which

³¹ *Id.*

³² Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 202(a), 95 Stat. 172, 219-20 (1981).

³³ I.R.C. § 179(b).

³⁴ No explanation was given for the change in treatment of married taxpayers. See S. REP. NO. 144, 97th Cong., 1st Sess. 60-61 (1981); S. REP. NO. 176, 97th Cong., 1st Sess. 209 (1981).

³⁵ See *infra* text accompanying notes 42-51. See, e.g., Bittker, *supra* note 4; Gann, *Abandoning Marital Status as a Factor in Allocating Income Tax Burdens*, 59 TEX. L. REV. 1 (1980); Jensen, *The Historical Discrimination of the Federal Income Tax Rates*, 54 TAXES 445 (1976); McIntyre & Oldman, *Taxation of the Family in a Comprehensive and Simplified Income Tax*, 90 HARV. L. REV. 1573 (1977).

³⁶ E.g., Brazer, *Income Tax Treatment of the Family*, in THE ECONOMICS OF TAXATION 223 (H. Aaron & M. Boskin ed. 1980) (urging that the individual be the unit for income taxation and outlining alternatives for the taxation of income from property held by married taxpayers); Gann, *supra* note 35 (suggesting mandatory separate filing under a single rate schedule as the most preferable alternative and arguing for disre-

should not bear upon tax liability. The competing view is that marriage represents an economic relationship which should be considered in allocating tax burdens among taxpayers.³⁷ It is urged that married taxpayers with equal aggregate incomes should bear identical tax burdens. However, some commentators advocating the married couple as a taxable unit also apply various criteria to determine the relative tax burdens of one-earner married couples, two-earner married couples, and single taxpayers.³⁸

Tax policy discussions concerning the relationship between marriage and tax liability are inconclusive. Writers have disagreed as to the extent of actual economic sharing in marriage and the role state law property rights should play in determining tax liability.³⁹ Also, disa-

gard of the effect of community property laws); Gerzog, *The Marriage Penalty: The Working Couple's Dilemma*, 47 *FORDHAM L. REV.* 27 (1978) (advocating permitting married couples to file separately and use the rate schedules available to single taxpayers); Mess, *For Richer, For Poorer: Federal Taxation and Marriage*, 28 *CATH. U.L. REV.* 87 (1978) (proposing separate filing with a federal definition of income which would eliminate differences attributable to state law); Munnell, *The Couple versus the Individual under the Federal Personal Income Tax*, in *THE ECONOMICS OF TAXATION* 247 (H. Aaron & M. Boskin ed. 1980) (arguing for the individual as the basic unit for the taxation of earned income and suggesting that unearned income be equally split between spouses); Rosen, *Is it Time to Abandon Joint Filing?*, 30 *NAT'L TAX J.* 423 (1977) (arguing for separate filing and disregard of community property laws); Note, *The Case for Mandatory Separate Filing by Married Persons*, 91 *YALE L.J.* 363 (1981) (advocating mandatory separate filing with adoption of arbitrary rules to allocate exemptions and deductions which present administrative difficulties).

³⁷ McIntyre, *supra* note 4 (arguing that critics of joint filing have not adequately addressed the economic relationship represented by marriage); Oldman & Temple, *Comparative Analysis of the Taxation of Married Persons*, 12 *STAN. L. REV.* 585, 603 (1960) (concluding that taxation of the married couple "is more reasonable, in terms of economic realities and administrative facility, than separate taxation of spouses"); see McIntyre & Oldman, *supra* note 35 (advocating adoption of a benefit rule for income attribution and suggesting separate filing and allocation of one-half of the couple's total income to each spouse).

³⁸ Oldman & Temple, *supra* note 37, at 603-04. Other writers have questioned the theoretical basis for these distinctions, arguing that it may not be possible to accurately ascertain the economic advantages of different living arrangements, or to establish appropriate fairness criteria to distinguish different taxpayers. Bittker, *supra* note 4, at 1422-25; McIntyre & Oldman, *supra* note 35, at 1574 n.2. However, as part of the Economic Recovery Tax Act of 1981, Congress enacted § 221 which permits a deduction for two-earner married couples. One of the justifications for this legislation was to decrease the disparity of treatment between one-earner and two-earner couples. S. REP. No. 144, 97th Cong., 1st Sess. 29-30 (1981).

³⁹ Compare Gann, *supra* note 35, at 26 (suggesting mandatory separate filing, disregarding the effect of community property laws, and stating "hard data does not generally substantiate the assumption that married persons equally share their income") with

greement exists concerning the relative tax burdens of different taxpaying units.⁴⁰ Professor Gann has summarized the current state of debate concerning these issues: "No one has yet suggested a system for allocation of tax burdens between married and single persons that is based on fairness criteria, accounts for the status of marriage, and receives the approval of all."⁴¹

A great deal of legislative attention has also been directed toward the relationship between marital status and tax rates. Prior to 1948, all taxpayers were required to use a single progressive rate schedule.⁴² This favored married couples living in community property states relative to those in common law states. Since under community property laws one-half of each spouse's income is attributed to the other spouse, couples in community property states were allowed to split their total income for tax purposes.⁴³ Income splitting reduces tax liability in a progressive rate structure because each half of the couple's income is subject to the lowest rates rather than being aggregated, with one-half taxed at higher marginal rates. A couple living in a community property state with \$30,000 of income would pay less tax than a couple living in a common law state with the same income unless each spouse's income was exactly \$15,000. As part of the Revenue Act of 1948, Congress largely eliminated geographical distinctions by extending the benefits of income splitting to all married couples. A second rate schedule was created which permitted married taxpayers filing jointly to pay twice as much tax as a single taxpayer with one-half the income.⁴⁴

McIntyre & Oldman, *supra* note 35, at 1596 (advocating adoption of a benefit rule and allocation of one-half of the couple's total income to each spouse; recognizing that accurate data are not available, the authors state, "a fifty-fifty division is based on the realistic assumption that married couples do pool their income, each obtaining more or less equal benefit").

⁴⁰ Compare Oldman & Temple, *supra* note 37, at 603-04 (urging that (1) a married couple with one spouse having income should pay more tax than a married couple with both spouses working, assuming both couples have equal income; (2) a dual income couple should pay more tax than two single individuals with the same incomes; and (3) a single person should pay the same or more tax than a married couple with the same total income) with McIntyre & Oldman, *supra* note 35, at 1574 n.2, 1595 n.80 (concluding that the criteria used by Oldman and Temple are inadequate).

⁴¹ Gann, *supra* note 35, at 29.

⁴² Bittker, *supra* note 4, at 1400; Gann, *supra* note 35, at 10.

⁴³ *Poe v. Seaborn*, 282 U.S. 101, 110 (1930) (state community property laws are given effect for federal tax purposes); see Bittker, *supra* note 4, at 1404-08; Gann, *supra* note 35, at 13-20.

⁴⁴ Revenue Act of 1948, ch. 168, §§ 301-303, 62 Stat. 114 (1948) (codified as various sections of the I.R.C.).

Thus, married couples with equal total incomes paid equal taxes regardless of state property laws.

The extension of income splitting to all married persons had a relative adverse impact upon single taxpayers. In 1951 Congress enacted a head of household rate schedule,⁴⁵ and in 1954 income splitting was extended to surviving spouses.⁴⁶ These acts granted a degree of income splitting to single taxpayers with family obligations similar to marriage. Later, in 1969, Congress examined the tax differential between single and married taxpayers and concluded that the disparity of treatment was excessive. As part of the Tax Reform Act of 1969, Congress enacted a new rate schedule for all single persons which limited the tax paid to no more than 120 percent of the tax paid by married taxpayers with the same taxable income.⁴⁷ Married taxpayers filing separately were required to use the former rate schedules for single persons to prevent them from paying less tax than if they filed jointly. As a consequence of the 1969 changes, married taxpayers with relatively equal incomes were required to pay more tax filing jointly than two single taxpayers with the same incomes.⁴⁸

Recently, this "marriage penalty" has been the subject of legislative attention. As part of the Economic Recovery Tax Act of 1981, Congress alleviated the penalty by creating a new deduction equal to a percentage of the earnings of the spouse with the lower earnings.⁴⁹ The change was justified by several policy grounds. First, large tax penalties on marriage are thought to undermine respect for both marriage and the

⁴⁵ Revenue Act of 1951, ch. 521, § 301, 65 Stat. 480 (1951) (current version at I.R.C. § 1(b)). See generally Bittker, *supra* note 4, at 1416-19.

⁴⁶ Internal Revenue Code of 1954, ch. 736, § 2, 68A Stat. 8 (1954) (current version at I.R.C. §§ 1(a), 2(a)). See generally Bittker, *supra* note 4, at 1416-19.

⁴⁷ Tax Reform Act of 1969, Pub. L. No. 91-172, § 803, 83 Stat. 678 (1969) (current version at I.R.C. § 1(c), (d)); S. REP. NO. 552, 91st Cong., 1st Sess. 260 (1969). See generally Bittker, *supra* note 4, at 1428-29.

⁴⁸ Bittker, *supra* note 4, at 1429-31. See generally Richards, *Discrimination Against Married Couples Under Present Income Tax Laws*, 49 TAXES 526 (1971); Richards, *Single v. Married Income Tax Returns Under the Tax Reform Act of 1969*, 48 TAXES 301 (1970); Note, *Federal Income Tax Discrimination Between Married and Single Taxpayers*, 7 U. MICH. J.L. REF. 667 (1974).

⁴⁹ The Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 103, 95 Stat. 172 (1981) (codified as I.R.C. § 221). For a criticism of the congressional solution, see Gann, *The Earned Income Deduction: Congress's 1981 Response to the "Marriage Penalty" Tax*, 68 CORNELL L. REV. 468 (1983). Congressional hearings were held in 1980 regarding the comparative tax treatment of married couples, single persons, and heads of household. *Tax Treatment of Married, Head of Household, and Single Taxpayers: Hearings Before the House Comm. on Ways and Means*, 96th Cong., 2d Sess. (1980).

tax system. Second, lower marginal rates applicable to the second earner's income should promote that spouse's entry into the labor market. Finally, the new deduction will decrease the disparity of treatment between one-earner and two-earner married couples. Congress accepted the argument that two-earner married couples should pay less tax than one-earner couples with the same income since the former incur more work related expenses and do not enjoy the tax-free benefits of the efforts of a nonworking spouse.⁵⁰ However, new section 221 does not eliminate the marriage penalty, it merely reduces it. Since the provision violates the principle that couples with equal aggregate incomes pay identical taxes, it reintroduced the issue of the tax effect of state property laws. Congress resolved the property law issue by providing that community property laws are to be disregarded for purposes of computing the base for the deduction.⁵¹

This brief history indicates that rather than being haphazard, much of the current disorder in the tax law concerning the relationship between marriage and tax liability is the consequence of the long-term development of a comprehensive statute. Many of the changes were politically motivated and the result of legislative compromise. However, they represent conscious, albeit at times conflicting, attempts to adjust the Code's treatment of marital relations.

The trends concerning marriage and the tax developments discussed in this Article require that additional legislative attention be given to marriage-based distinctions. They may result in significant shifts in the tax law's treatment of marital status and tax rates. Shifts in taxpayer views regarding marriage and an increased awareness of tax distinctions resting upon marital status will fuel debate concerning marriage's role in determining an individual's tax liability.⁵²

II. DETERMINING MARITAL STATUS FOR TAX PURPOSES

The Internal Revenue Code determines the tax consequences of events which have independent state law effect.⁵³ The interaction between local law and the federal income tax has been described by the Supreme Court:

State law creates legal interests and rights. The federal revenue acts designate what interests or rights, so created, shall be taxed. Our duty is to ascertain the meaning of words used to specify the thing taxed. If it is

⁵⁰ S. REP. NO. 144, 97th Cong., 1st Sess. 29-30 (1981).

⁵¹ I.R.C. § 221(b)(1).

⁵² See *infra* text accompanying notes 130-46.

⁵³ FEDERAL TAXATION, *supra* note 11, at ¶ 4.1.1.

found in a given case that an interest or right created by local law was the object intended to be taxed, the federal law must prevail no matter what name is given to the interest or right by state law.⁵⁴

Marital status for tax purposes is generally determined at year-end.⁵⁵ While the meaning of a term in the Code is a federal question, courts have consistently looked to state-defined marital status to determine whether an individual is married for tax purposes.⁵⁶ Deference has been accorded to local law because marriage, its existence and dissolution, is uniquely within the province of the states.⁵⁷ If taxpayers are married under local law at the close of their taxable year, they are generally viewed as married by the Internal Revenue Code.⁵⁸ Accept-

⁵⁴ *Morgan v. Commissioner*, 309 U.S. 78, 80-81 (1940) (state law characterization of a power of appointment is not relevant for federal estate tax purposes).

⁵⁵ I.R.C. §§ 143, 6013.

⁵⁶ *See, e.g., Boyter v. Commissioner*, 74 T.C. 989 (1980) (concluding that Maryland would not recognize Haitian and Dominican Republic divorces; thus the divorces had no effect for tax purposes), *remanded*, 668 F.2d 1382 (4th Cir. 1981); *Eccles v. Commissioner*, 19 T.C. 1049 (interlocutory decree of divorce which did not constitute a decree for separate maintenance did not end the matrimonial status of the parties until lapse of six months so that the taxpayer could file a joint return with his wife), *aff'd per curiam*, 208 F.2d 796 (4th Cir. 1953). *But see* *Estate of Borax v. Commissioner*, 349 F.2d 666 (2d Cir. 1965) (adopting a rule of validation to recognize a Mexican divorce for tax purposes despite a declaration by a New York court that the divorce was invalid), *cert. denied*, 383 U.S. 935 (1966); *Feinberg v. Commissioner*, 198 F.2d 260 (3d Cir. 1952) (payments made by a husband to his wife were deductible as alimony although a New York court declared the Florida divorce obtained by the husband a nullity). The Supreme Court has held that state law may control when the Code, "by express language or necessary implication, makes its own operation dependent upon state law." *Burnet v. Harmel*, 287 U.S. 103, 110 (1932); *see also* *FEDERAL TAXATION*, *supra* note 11, at ¶ 4.1.1. Courts have relied upon the absence of general federal law definitions of marriage to conclude that Congress intended state-defined marital status to be used for federal tax purposes. *Lee v. Commissioner*, 64 T.C. 552, 558 (1975), *aff'd per curiam*, 550 F.2d 1201 (9th Cir. 1977).

⁵⁷ *Boyter v. Commissioner*, 74 T.C. 989, 994 (1980), *remanded*, 668 F.2d 1382 (4th Cir. 1981); *Gersten v. Commissioner*, 28 T.C. 756, 770 (1957), *aff'd in part, remanded in part*, 267 F.2d 195 (9th Cir. 1959); *Eccles v. Commissioner*, 19 T.C. 1049, 1051, *aff'd per curiam*, 208 F.2d 796 (4th Cir. 1953). Some courts have mistakenly suggested that state-defined marital status is controlling due to full faith and credit obligations or principles of collateral estoppel. Comment, *State Domestic Relations Law and Federal Tax Policy*, 66 COLUM. L. REV. 150, 152 (1966); *see* Note, *Divorce, Conflict of Laws, and the IRS — The "Rule of Validation" As a Solution to Matrimonial Tax Difficulties*: *Estate of Spalding v. Commissioner*, 9 CONN. L. REV. 282, 287-90 (1977) [hereafter, Note, *Divorce, Conflict of Laws, and the I.R.S.*].

⁵⁸ However, a taxpayer is considered married even if not married at the end of the taxable year if the taxpayer's spouse died during the year. I.R.C. §§ 143(a)(1), 6013(a)(2).

ance of state concepts of marriage also extends to common law marriages which, if valid in the state in which they are undertaken, are recognized for tax purposes.⁵⁹ Additionally, the Internal Revenue Service generally will not challenge the validity of any divorce decree until the decree is declared invalid by a court of competent jurisdiction.⁶⁰

Congress, however, has mandated federal definitions of marital status in a limited number of tax provisions. If applicable, these definitions supersede local law determinations of marital status. For example, individuals who are legally separated from their spouses under a decree of divorce or separate maintenance are often considered single for purposes of determining their federal income tax liability.⁶¹ Also, if a husband and wife live apart during the entire taxable year, one or both is considered single if that individual provides over one-half of the cost of a home in which the individual resides with a dependent child.⁶²

The process of determining marital status for tax purposes is illustrated by *Capodanno v. Commissioner*.⁶³ Lilley and R.T. Capodanno were married and lived together until 1964. In 1965, Lilley instituted an action against R.T. under New Jersey's separate maintenance statute, and in 1971, the New Jersey Supreme Court awarded her \$400 per month retroactive to the day the action was filed. In her 1971 federal income tax return, Lilley claimed to be single, relying upon section 143(a)(2), which considers married taxpayers legally separated under a decree of divorce or separate maintenance single for return filing purposes.

The Tax Court began by noting that section 143 requires the decree to effectuate a legal separation — it must expressly and affirmatively

⁵⁹ *Von Tersch v. Commissioner*, 47 T.C. 415 (1967); *Peveler v. Commissioner*, 39 T.C.M. 502 (1979); *Ross v. Commissioner*, 31 T.C.M. 488 (1972); *Amaro v. Commissioner*, 29 T.C.M. 914 (1970); Rev. Rul. 58-66, 1958-1 C.B. 60.

⁶⁰ Rev. Rul. 67-442, 1967-2 C.B. 65 (the validity of a divorce will not be questioned for tax purposes until a court of competent jurisdiction declares the divorce invalid); Rev. Rul. 71-390, 1971-2 C.B. 82 (a Mexican divorce was not questioned since a court of competent jurisdiction had not declared the divorce invalid). *But see* *Gersten v. Commissioner*, 267 F.2d 195 (9th Cir. 1959).

⁶¹ *E.g.*, I.R.C. §§ 44A(f)(3), 121(d)(6)(B), 143(a)(2), 6013(d)(2). One commentator has urged expansion of this standard to permit more married taxpayers living apart to file as single individuals. Hesch, *Separated Couples and the Marriage Penalty*, 45 ALB. L. REV. 116 (1980). Professor Hesch recognized the possibility of abuse of more liberal standards and suggested recognition of court support orders only, or a requirement that taxpayers live apart in order to file as single taxpayers. *Id.* at 136.

⁶² I.R.C. § 143(b).

⁶³ 69 T.C. 638 (1978), *aff'd*, 602 F.2d 64 (3d Cir. 1979).

provide that the parties live apart.⁶⁴ The court examined New Jersey law to ascertain the effect of the decree of separate maintenance and concluded that it did not constitute a legal separation. The original marital relationship was unaltered for determining return filing status.⁶⁵

Capodanno illustrates the manner in which local law and federal tax law interact to arrive at a tax marital status. Initially, the court looked to the state law effect of the decree to analyze whether section 143 required the taxpayers to be treated as single despite their existing marital status. Satisfied that those federal standards were not met, the court then, without discussion, adopted the taxpayers' state-defined marital status for federal tax purposes.

The tax law's reliance upon state-defined marital status as an operative tax factor occasionally produces anomalous tax results. To illustrate, section 1239 of the Code provides that gain recognized upon the sale or exchange of property between spouses is to be treated as ordinary income if the property is depreciable in the hands of the transferee.⁶⁶ The section is designed to prevent tax benefits which would otherwise result upon a sale of appreciated depreciable property between related persons. Absent that provision, a purchaser could obtain a fair market value basis in depreciable property for the relatively small cost of a capital gains tax to the related seller. The increased basis would generate larger future depreciation deductions which offset ordinary income; the difference between these future tax savings and the current capital gains tax to the seller could make the transaction financially beneficial to the parties, since their combined tax burden would be reduced. Congress, in section 1239, recognized the community of economic interest that generally exists between spouses and denied this benefit by characterizing the seller's gain as ordinary income and raising the tax cost of the basis increase.⁶⁷

In *Deyoe v. Commissioner*,⁶⁸ Elizabeth Deyoe sold her community property interest in appreciated depreciable property to her husband as part of a divorce settlement. Determining that the sale took place prior to the entry of the divorce decree, the Internal Revenue Service asserted that section 1239 required Elizabeth's gain to be characterized as ordi-

⁶⁴ 69 T.C. at 647.

⁶⁵ *Id.* at 648.

⁶⁶ I.R.C. § 1239(a), (b)(1).

⁶⁷ JOINT COMM. STAFF, 82D CONG., 1ST SESS., SUMMARY OF PROVISIONS OF THE REVENUE ACT OF 1951, reprinted in 1951-2 C.B. 287, 314.

⁶⁸ 66 T.C. 904 (1976).

nary income. The Tax Court upheld the Service's position, relying upon the fact that the taxpayers were married under state law at the time of the sale.⁶⁹ The court was not persuaded that section 1239 should be limited to situations involving an ongoing marriage, when it can be assumed that the seller retains some control of the asset. The court, while agreeing that section 1239's policy did not extend to the divorce situation, felt constrained by the absence of an explicit statutory exception for dissolution proceedings.⁷⁰ The irony is that if the Deyoes had planned the sale to occur following the divorce, there is little doubt that the sting of section 1239 would have been avoided.⁷¹

Similarly, the tax law's limited attempts to define marital status create distinctions which are difficult to reconcile on theoretical grounds. Why should spouses legally separated by a decree be treated as single taxpayers while a "married" couple under an interlocutory decree of divorce is considered married?⁷² Is there any significant difference which should alter their tax situations? Why should the tax law recognize a marital relationship that has broken down with the parties executing a written separation agreement and fail to recognize the relationship between an unmarried couple which lives together and has raised children?⁷³ Which relationship more closely resembles traditional concepts of marriage?

A great deal, but not all, of this confusion is attributable to the need for certainty in the tax laws.⁷⁴ Fixed and immutable boundaries within

⁶⁹ *Id.* at 913.

⁷⁰ Support for the decision was also found in the Internal Revenue Service's historical inability to establish that couples under interlocutory decrees of divorce are not husband and wife for the purposes of certain tax provisions. *Id.* at 914-15.

⁷¹ *duPont v. Commissioner*, 37 T.C.M. 115, 124-25 (1978) (transfers of assets pursuant to a property settlement which became effective after divorce were not subject to § 267 or § 1239).

⁷² Compare I.R.C. § 143(a)(2) (an individual legally separated under a decree of divorce or separate maintenance is not married) with *Commissioner v. Ostler*, 237 F.2d 501 (9th Cir. 1956) (husband and wife permitted to file joint return prior to interlocutory decree of divorce becoming final); *Eccles v. Commissioner*, 19 T.C. 1049 (joint return permitted before interlocutory decree became effective), *aff'd per curiam*, 208 F.2d 796 (4th Cir. 1953); and *Rev. Rul. 57-368*, 1957-2 C.B. 896 (acquiescence substituted for nonacquiescence in *Eccles*).

⁷³ Compare *Donigan v. Commissioner*, 68 T.C. 632 (1977) (a taxpayer separated under a written separation agreement is not entitled to file as a single individual) with *Peacock v. Commissioner*, 37 T.C.M. 177 (1978) (taxpayer and a woman with whom he had lived and had had two children were not "spouses" for purposes of the dependency and medical expenses deductions).

⁷⁴ Congress has, however, demonstrated the ability to make more subtle distinctions concerning the nature of family relationships. Sections 66 and 879 of the Code provide

any body of law produce questionable results near the border; they also generate significant benefits. Established and certain principles in the income tax assist both taxpayers and the government. Individuals are able to plan their affairs with relative certainty as to the tax consequences and the government's administrative burden is lightened by laws which generate distinct answers. The inclination to achieve tax results which reflect reality must be tempered by concern for the future utility of the statute. The benefits of certainty must be balanced against the vice of occasional inequity.⁷⁵

These concerns should not mandate stagnation. Rather, they indicate that one should approach the problem with caution, recognizing that any improvements in the income tax's use of marital status as a taxing factor or the processes for determining that status will likely be flawed. They may also be temporary. Professor Bittker, while examining the pressures upon the Internal Revenue Code resulting from changing societal views concerning the family, has observed that any current tax reforms generated by today's social trends will be "as particularistic and transitory as the laws they supplant."⁷⁶

III. TAX-MOTIVATED DIVORCES

Historically, taxpayers have not manipulated marital status as a tax planning device. The tax consequences of marriage and divorce have been closely examined and planning often plays a significant role in those events,⁷⁷ but, despite potential savings, large numbers of taxpayers have not attempted temporary marriages or divorces to reduce tax liability. There are undoubtedly numerous reasons for this behavior. The failure of individuals to manipulate marital status for tax benefits is quite likely a manifestation of their attitude toward the personal and legal relationships embodied in marriage. An individual might understandably value those considerations over a potential financial gain and

that the effect of state community property laws will be disregarded if a married couple lives apart during the year, does not file jointly, and no part of any earned income which is community income is transferred between the spouses.

⁷⁵ See Bittker, *supra* note 4, at 1398-99.

⁷⁶ *Id.* at 1392.

⁷⁷ E.g., Goetting, *Tax Aspects of Marital Separation*, 40 N.Y.U. INST. FED. TAX. 28-1 (1982); Hjorth, *Community Property Marital Settlements: The Problem and a Proposal*, 50 WASH. L. REV. 231 (1975); Kramer, *Estate Planning for the Stable and Not-So-Stable Marriage and Nonmarital Cohabitation*, 39 N.Y.U. INST. FED. TAX. 56-1 (1981); Taylor & Schwartz, *Tax Aspects of Marital Property Agreements*, 7 TAX L. REV. 19 (1951); Tilt & Spencer, *Tax Consequences of Annulments*, 61 TAXES 65 (1983).

opt against disturbing the relationships even on a transitory basis.⁷⁸ Ignorance of the tax law may also be a factor. Restrictive state laws may make these strategies difficult. It could also be that taxpayers have consciously balanced potential tax savings against the expense and effort required to alter marital status and decided the financial benefits are outweighed by these factors.

Some taxpayers, however, appear to be changing their views. Married and unmarried individuals seem to be increasingly willing to vary their marital status to obtain tax benefits. Year-end divorces have been used in attempts to save taxes, and commentators have suggested year-end marriages as a potential tax savings device for unmarried cohabitants.⁷⁹ The reasons behind these developments are as complex as those underlying the earlier reluctance of individuals to pursue these strategies. Possibly, the tax stakes involved have risen to a level which has increased awareness of potential savings and makes marital status changes economically viable.⁸⁰ Changing social mores are unquestionably a factor. Also, recent trends blurring the legal distinctions between marital and less formal relationships may have reduced the importance of marital status,⁸¹ making movement in and out of marriage less significant and a more acceptable means for reducing taxes.

A. *Potential Tax Savings from Tax-Motivated Divorces*

Whatever the reason behind these trends, there are potentially significant tax savings available if tax-motivated divorces,⁸² typically under-

⁷⁸ Professor Bittker has suggested that some of these considerations underlie the reluctance of family members to engage in tax motivated transactions. Bittker, *supra* note 4, at 1394.

⁷⁹ *Boyter v. Commissioner*, 74 T.C. 989 (1980) (year-end divorces obtained in Haiti and Dominican Republic to permit filing as single taxpayers), *remanded*, 668 F.2d 1382 (4th Cir. 1981); Rev. Rul. 76-255, 1976-2 C.B. 40 (situation 2: year-end foreign divorce obtained to permit separate filing as single individuals); Private Ruling 7835076 (June 1, 1978) (divorce obtained to permit filing as single individuals and the taxpayers intend to continue to live together); J. SONENBLICK, *supra* note 18, at 158-61; Randall, *supra* note 18, at 32; Wenig, *supra* note 2, at § 5.11.

⁸⁰ In *Boyter v. Commissioner*, 74 T.C. 989 (1980), *remanded*, 668 F.2d 1382 (4th Cir. 1981), the taxpayers obtained divorces at the end of 1975 and 1976 in order to file as single individuals. The deficiencies related to this issue totalled \$1,198.34 for 1975 and \$1,937 for 1976. Also, the Boyters estimated that the marriage penalty would cost them at least \$130,000 over their lifetimes. *Tax Treatment of Married, Head of Household, and Single Taxpayers: Hearings Before the Comm. on Ways and Means*, 96th Cong., 2d Sess. 164 (1980) (statements of David and Angela Boyter).

⁸¹ See *infra* notes 13-15, 17 and accompanying text.

⁸² One author has coined the term "boomerang divorce" to describe a divorce ob-

taken with a view toward remarriage or to return the individuals to an unmarried status, are recognized for tax purposes. Two sets of tax provisions, the rate schedules and the alimony provisions, are particularly susceptible to abuse by this strategy.

Currently, individuals are taxed at different rates depending upon their marital status. Married couples are permitted to file jointly or separately, and the tax rates for married taxpayers filing jointly are exactly the same as the rates for married taxpayers filing separately, but the brackets for joint returns are twice as wide. This situation permits married couples filing jointly to pay the same tax they would pay if their aggregate taxable income was divided between them and they filed separately.⁸³ This income splitting benefit makes it seldom advantageous for married taxpayers to file separately.⁸⁴ Single taxpayers, other than surviving spouses and heads of households, are taxed at rates which result in tax liability up to 20% higher than that for married couples with the same income, but less than the taxes paid by a married taxpayer filing separately with the same income.⁸⁵

Because married taxpayers filing separately use rates which exceed the rates applied to single individuals, a "marriage penalty" may result if single individuals having relatively equal taxable incomes marry. In the Economic Recovery Tax Act of 1981, Congress acted to mitigate the marriage penalty by allowing married taxpayers filing jointly a deduction equal to ten percent (five percent in 1982) of the lesser of \$30,000 or the earned income of the spouse with the lower earned income.⁸⁶ The new provision still fails to eliminate the potential tax incentive in divorce. For example, if *C* and *D* are married and earn sala-

tained to manipulate tax marital status. J. SONENBLICK, *supra* note 18, at 158.

⁸³ I.R.C. § 1(a), (d); 1980 JOINT COMM. PRINT, *supra* note 3, at 8; FEDERAL TAXATION, *supra* note 11, at ¶ 111.3.

⁸⁴ Married taxpayers may reduce their total tax liability by filing separately if one spouse has a large amount of deductions which are allowed only to the extent they exceed a percentage of adjusted gross income. For example, if one spouse has a large casualty loss or medical expense during the year and the couple has relatively equal incomes, the couple may benefit by filing separately since the deduction limitation would only be a percentage of the spouse's, rather than the couple's, adjusted gross income. Married couples may also file separately for reasons of privacy, when the relationship has broken down, or to avoid joint liability with respect to the return. 1980 JOINT COMM. PRINT, *supra* note 3, at 9; FEDERAL TAXATION, *supra* note 11, at ¶ 111.3.2. It is estimated that only 1.3% of all married couples file separately. 1980 JOINT COMM. PRINT, *supra* note 3, at 48.

⁸⁵ I.R.C. § 1(a), (c), (d); 1980 JOINT COMM. PRINT, *supra* note 3, at 9.

⁸⁶ The Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 103, 95 Stat. 172 (1981) (codified as I.R.C. § 221).

ries of \$30,000 and \$25,000 they would be entitled to a \$2,500 deduction under section 221 and, if they file jointly, would have a total tax liability of \$12,214 in 1983. If *C* and *D* were single, their total tax would be \$10,626; marriage would increase their tax liability by \$1,588.⁸⁷ Since marital status for filing purposes is generally determined on the last day of the taxable year, it is not surprising that married couples with relatively equal incomes would consider temporary year-end divorces to obtain these tax savings.

The rate schedules do not consistently favor divorce. Single couples might also consider year-end changes of marital status to reduce their total tax burden. If *E* and *F* are single and have \$35,000 of taxable income, all of which was earned by *E*, their 1983 tax would be \$7,917. If they married, the income splitting benefit in the joint return privilege and the additional personal exemption would reduce their total tax to \$5,964; thus, a temporary year-end marriage would save *E* and *F* \$1,953 in taxes.⁸⁸

Sections 71 and 215 of the Code provide that if a couple is divorced or legally separated under a decree of divorce or of separate maintenance, periodic payments discharging the payor's marital support obligations constitute income to the recipient and are deductible by the payor.⁸⁹ The effect of these provisions is to allow divorced taxpayers to shift the incidence of taxation from the payor to the recipient with respect to the payments.⁹⁰ A temporary shift in marital status could thus

⁸⁷ The calculations in the text assume the taxpayers have no other deductions, are each allowed one \$1,000 exemption, do not have excess itemized deductions, and do not have to make an unused zero bracket amount computation under § 63(e). In the example, *C* and *D*'s marginal tax rate if filing jointly is 40%. As unmarried taxpayers, *C*'s marginal tax rate is 30% and *D*'s is 32%.

⁸⁸ As a single individual, *E*'s marginal tax rate is 36%. If *E* and *F* file jointly their marginal tax rate is 30%.

⁸⁹ I.R.C. §§ 71(a)(1), 215(a). Sections 71 and 215 provide the same treatment for payments made pursuant to a written separation agreement or a decree for support which discharges the payor's support obligations. I.R.C. §§ 71(a)(2), (3), 215(a).

⁹⁰ The progenitors of §§ 71 and 215 were originally partially justified as a relief measure from the high World War II tax rates. Under these provisions, the payor was no longer taxed upon alimony payments made to the former spouse. See H.R. REP. NO. 2333, 77th Cong., 1st Sess. 71-72 (1942), *reprinted in* 1942-2 C.B. 427; S. REP. NO. 1631, 77th Cong., 2d Sess. 83 (1942), *reprinted in* 1942-2 C.B. 568.

The income splitting or assignment of income potential in these provisions was more fully recognized when, as part of the Tax Reform Act of 1976, the § 215 deduction was made allowable in arriving at adjusted gross income. Tax Reform Act of 1976, Pub. L. No. 94-555, § 502(a), 90 Stat. 1559 (1976); STAFF OF JOINT COMM. ON TAXATION, 94TH CONG., 2D SESS., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1976 116 (Comm. Print 1976).

be used as an income splitting strategy. If married, *C* and *D* in the previous example could reduce their 1983 federal tax liability by an additional \$8 if they required *C*, in a year-end divorce settlement, to make \$2,500 in periodic payments to *D*. The payments would be taxable to *D* and deductible by *C*, equalizing their respective taxable incomes and further reducing their taxes. This strategy would provide large financial rewards to married couples with greatly disparate incomes. They could obtain a year-end divorce, use the alimony provisions of the Code to equalize their incomes, and take advantage of the more favorable tax rates for single taxpayers. Even unmarried taxpayers could obtain tax benefits through the divorce provisions. A temporary marriage and subsequent divorce have been suggested as an income splitting strategy.⁹¹

Many of these strategies entail legal and practical difficulties. Commentators have recognized the ethical issues involved in using state courts to achieve temporary divorces;⁹² perhaps that explains why tax-motivated divorces generally have been attempted in foreign jurisdictions.⁹³ Additionally, some of these options, such as strategies using alimony payments, require permanent financial commitments which an individual might be reluctant to undertake despite potential tax savings.

B. Revenue Ruling 76-255, Private Ruling 7835076, and Boyter v. Commissioner

Revenue Ruling 76-255⁹⁴ was the Internal Revenue Service's first pronouncement dealing with tax-motivated divorces. In the ruling, *C* and *D*, a married couple, obtained a valid foreign divorce on December 30, 1975, and remarried in January 1976. The divorce was obtained to enable *C* and *D* to file returns as single individuals, and they intended, at the time of divorce, to remarry early in the succeeding year. The ruling states that neither section 143 nor section 6013 contemplates a sham transaction designed to manipulate marital status for income tax purposes. Abandoning state-defined marital status, the ruling relies

⁹¹ J. SONENBLICK, *supra* note 18, at 160; Wenig, *supra* note 2, at § 5.11.

⁹² J. SONENBLICK, *supra* note 18, at 158-59 (one of the parties must commit perjury to establish that the marriage is irretrievably broken or to prove fault if grounds for divorce are not present).

⁹³ See *Boyter v. Commissioner*, 74 T.C. 989 (1980) (year-end divorces obtained in Haiti and the Dominican Republic), *remanded*, 668 F.2d 1382 (4th Cir. 1981); Rev. Rul. 76-255, 1976-2 C.B. 40 (situation 2: year-end divorce obtained under the law of a "foreign jurisdiction").

⁹⁴ 1976-2 C.B. 40 (situation 2).

upon *Gregory v. Helvering*⁹⁵ to conclude that the divorce had no effect for tax purposes since the parties intended to and did remarry. Accordingly, *C* and *D* were required to file as married individuals, either jointly or separately, for 1975.

What if the taxpayers in Revenue Ruling 76-255 had not remarried but continued to cohabit? Would they achieve the desired tax result? Undoubtedly, the Service would view them as single individuals following their divorce. In Private Ruling 7835076,⁹⁶ the Service considered the marital status of a couple who planned a year-end divorce for tax reasons and did not intend to remarry. The Service concluded the taxpayers would be considered unmarried if they were legally divorced by year-end and seemed to distinguish Revenue Ruling 76-255 based upon the absence of an intention to remarry.⁹⁷

⁹⁵ 293 U.S. 465 (1935). Mrs. Gregory owned all of the stock of a corporation which owned 1000 shares of the Monitor Securities Corporation. To obtain the Monitor shares, Mrs. Gregory formed the Averill Corporation, had the Monitor shares transferred to that corporation in what was ostensibly a tax free reorganization, and then liquidated the Averill Corporation reporting a capital gain on the liquidation. Absent the tax free reorganization, the receipt of Monitor shares would have been a dividend, and Mrs. Gregory would have paid more tax. Although the steps taken satisfied the statutory requirements for a reorganization, the Court concluded that Congress did not intend for tax free treatment to be extended to transactions "having no business or corporate purpose." *Id.* at 469. In affirming a decision in favor of the Internal Revenue Service, the Court established the basis for the sham transaction doctrine:

The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted. But the question for determination is whether what was done, apart from the tax motive, was the thing which the statute intended

. . . .

In these circumstances, the facts speak for themselves and are susceptible of but one interpretation. The whole undertaking, though conducted according to the terms of subdivision (B), was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization, and nothing else. The rule which excludes from consideration the motive of tax avoidance is not pertinent to the situation, because the transaction upon its face lies outside the plain intent of the statute. To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose.

Id. at 469-70 (citations omitted).

⁹⁶ June 1, 1978.

⁹⁷ The private ruling's finding that the taxpayers were single was cryptically conditioned by the requirement that there be "no factors present that indicate otherwise." Private Ruling 7835076 (June 1, 1978). Case law supports the ruling's conclusion. In *Peveler v. Commissioner*, 39 T.C.M. 502 (1979), the Tax Court held that taxpayers who had divorced but continued to live together did not satisfy state law standards for

Boyter v. Commissioner,⁹⁸ the first case to consider the tax effect of tax-motivated divorces, involved a taxpayer attempt to avoid the marriage penalty by utilizing year-end divorces.⁹⁹ In late 1975, Angela and David Boyter traveled to the Republic of Haiti where they obtained a decree of divorce on grounds of incompatibility of character. After returning to Maryland, Angela and David remarried on January 9, 1976. In November of 1976, the Boyters traveled to the Dominican Republic where they again divorced, this time alleging incompatibility of temperament as the basis for the action. On February 10, 1977, the Boyters again remarried. Both the Haitian and Dominican divorce decrees recited the fact that the Boyters resided and were domiciled in Maryland.

The Boyters contended that since they were not married as of the close of their 1975 and 1976 taxable years, they were entitled to file as single individuals for those years, thereby avoiding the marriage penalty. The Internal Revenue Service maintained that they were married individuals during those years because the foreign divorces would not be recognized as valid in Maryland, since the foreign courts did not have subject matter jurisdiction over the proceedings and the taxpayers made material misrepresentations to the foreign court.¹⁰⁰ Additionally, the Service argued that even if the divorce decrees were recognized as valid for state law purposes, they should be disregarded for federal income tax purposes because they amounted to sham transactions.¹⁰¹

Although there was no statutory guidance and no clear decision from Maryland's highest court, the Tax Court agreed with the Service that Maryland would not recognize the foreign divorces because the foreign courts lacked subject matter jurisdiction. The court, adhering to the view that state-defined marital status is controlling for tax purposes, noted that Maryland's recognition of the Boyters' Haitian and Dominican divorces would be governed by principles of comity which required the foreign tribunals to obtain jurisdiction to render the judgments.

recognition of a common law marriage and therefore could not file a joint return as husband and wife.

⁹⁸ 74 T.C. 989 (1980), *remanded*, 668 F.2d 1382 (4th Cir. 1981).

⁹⁹ The Boyters admitted that their divorces were undertaken solely to reduce their tax liability. Brief for Petitioners at 10, *Boyter v. Commissioner*, 74 T.C. 989 (1980) (copy on file at U.C. Davis Law Review office).

¹⁰⁰ The Internal Revenue Service argued that the Boyters falsely and intentionally deceived the foreign tribunals in establishing grounds for their divorces. Brief for Respondent at 23-30, *Boyter v. Commissioner*, 74 T.C. 989 (1980) (copy on file at U.C. Davis Law Review office).

¹⁰¹ 74 T.C. at 993.

Domicile of one of the spouses in the foreign jurisdiction is generally a prerequisite to recognition of a foreign court's divorce decree. Since the Boyters at all times resided and were domiciled in Maryland, the Tax Court reasoned that Maryland's highest court would not recognize the foreign divorces as valid terminations of the marriage.¹⁰² This disposition of the case made it unnecessary to consider the Service's contention that the divorces should be disregarded as shams.

On appeal, the Fourth Circuit remanded the case to the Tax Court to consider whether the divorces, even if valid under state law, should be disregarded for federal tax purposes. The court began by noting its agreement with the principle that state law controls the determination of marital status for tax purposes. However, the Fourth Circuit concluded that Maryland law was ambiguous regarding the validity of migratory divorces obtained in a foreign country. The court considered using Maryland's certification procedure to ask the state court of appeals to determine the validity of the divorces but decided, based upon considerations of comity, not to invoke the process. The Fourth Circuit reasoned that a Maryland court ruling would not dispose of the case if the state court ruled the foreign divorces were valid since it would still be necessary to consider the Service's contention that the divorces were shams.¹⁰³ Thus, it was necessary to address whether the divorces could be disregarded even if valid.

The Fourth Circuit then considered the applicability of the sham transaction doctrine to divorces. It noted that the doctrine had been used by courts to disregard the form of commercial transactions to apply the tax laws to the substance or economic reality of a transaction, and held the same principles applicable to divorces. Additionally, the court found support for its position in cases disregarding the liquidation of a corporation which subsequently reincorporates and continues operations:¹⁰⁴

¹⁰² *Id.* at 995-97.

¹⁰³ 668 F.2d at 1385.

¹⁰⁴ The court cited three cases: *Rose v. United States*, 640 F.2d 1030 (9th Cir. 1981) (purported liquidation of a corporation was an I.R.C. § 368(a)(1)(D) reorganization; demonstration of a valid business purpose for the sale and liquidation does not change the classification); *Atlas Tool Co. v. Commissioner*, 614 F.2d 860 (3d Cir.) (liquidation-reincorporation was in fact an I.R.C. § 368(a)(1)(D) reorganization; tax avoidance motive does not have to be demonstrated), *cert. denied sub nom. Schaffan v. Commissioner*, 449 U.S. 836 (1980); and *Pridemark, Inc. v. Commissioner*, 345 F.2d 35 (4th Cir. 1965) (a complete liquidation when corporate assets were sold to an unrelated purchaser and business was not resumed for over one year), *overruled in different part*, *Of Course, Inc. v. Commissioner*, 499 F.2d 754 (4th Cir. 1974).

The underlying purpose of the transaction, viewed as a whole, is for the taxpayers to remain effectively married while avoiding the marriage penalty in the tax laws. It is the prompt remarriage that defeats the apparent divorce when assessing the taxpayers' liability, just as the prompt reincorporation of a business enterprise in continuous operation defeats the apparent liquidation of the predecessor corporation.¹⁰⁵

The court went on to state the standard it thought applicable: "Thus, the sham transaction doctrine may apply in this case if, as the record suggests, the parties intended merely to procure divorce papers rather than actually to effect a real dissolution of their marriage contract."¹⁰⁶ The Fourth Circuit concluded that the Tax Court, as trier of fact, was the only body competent to make this determination.¹⁰⁷

The Service's attempts in Revenue Ruling 76-255 and *Boyter* to prevent manipulation of the Code's provisions through tax-motivated divorces are appropriate. The marriage penalty is a product of competing goals: (1) taxing all married couples equally regardless of the source of income within the marital unit; and (2) designing rate schedules so that a single individual pays a tax which is not significantly greater than the tax imposed upon a married couple with the same amount of taxable income.¹⁰⁸ By adopting new rate schedules in 1969 to reduce the difference between the rates paid by single and married persons, Congress required married couples to pay more total tax than two single persons each earning approximately one-half of the couples' income. This result was justified by a comparison of living expenses incurred by a married couple relative to single persons. A married couple is likely to have living expenses which are greater than a single person with the same income, and, therefore, the couple should pay less tax. But, since a married couple can typically live for less than two single persons living apart, it was thought that the married taxpayers should pay more tax than two single persons, each having one-half the couple's income.¹⁰⁹

¹⁰⁵ *Boyter*, 668 F.2d at 1387.

¹⁰⁶ *Id.* (footnote omitted). The court stated that evidence that the taxpayers may have practiced fraud upon the courts granting the divorces is relevant to their intention. *Id.* at n.7.

¹⁰⁷ *Id.* at 1388.

¹⁰⁸ 1980 JOINT COMM. PRINT, *supra* note 3, at 23-24, 26-27; FEDERAL TAXATION, *supra* note 11, at ¶ 111.3.5; Bittker, *supra* note 4, at 1429-31.

¹⁰⁹ STAFF OF JOINT COMM. ON INTERNAL REVENUE TAXATION, 91ST CONG., 1ST SESS., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1969 223 (Comm. Print 1970); *Tax Treatment of Single Persons and Married Persons Where Both Spouses are Working: Hearings Before the House Comm. on Ways and Means*, 92d Cong., 2d Sess. 100 (1972) (statement of Representative Schwengel); 1980 JOINT COMM. PRINT, *supra* note 3, at 24. For the view that Congress did not realize that its

Some commentators have been less certain that a discernable policy justification exists for the marriage penalty,¹¹⁰ but that does not mandate recognition of tax-motivated divorces. Congress clearly did not intend application of the tax rate schedules to be elective; the Service's position in Revenue Ruling 76-255 and *Boyter* is consistent with that goal. When Congress created new rate schedules for single persons in 1969, the pre-1969 rate schedule for single persons was retained for married persons filing separately. Otherwise, if each spouse were allowed to use the new schedules for single persons, couples in community property states could be taxed at rates lower than if they filed jointly.¹¹¹ This result would undercut the policy that couples with equal incomes should pay equal taxes.¹¹²

C. Manipulation of State-Defined Marital Status

To prevent manipulation of the tax laws, the Service in Revenue Ruling 76-255 and the Fourth Circuit in *Boyter* were willing to abandon the principle that local law determines marital status for federal tax purposes. This is a positive analytical step since state-defined marital status is potentially susceptible to manipulation and continued reliance upon state definitions of marriage could compromise tax policy and produce unprincipled results.

The potential for manipulation of marital status is indicated in *Boyter*. Despite the Fourth Circuit's concern regarding Maryland law, *Boyter* involved facts which did not seriously challenge the traditional view that state-defined marital status determines marital status for tax purposes. Since the Boyters resided in Maryland at all times and the Haitian and Dominican decrees acknowledged the Boyters' Maryland

1969 changes would result in the marriage penalty, see Note, *The Haitian Vacation: The Applicability of Sham Doctrine to Year-End Divorces*, 77 MICH. L. REV. 1332, 1346-47 (1979) [hereafter Note, *The Haitian Vacation*].

¹¹⁰ See, e.g., Gerzog, *supra* note 36, at 31-36; Mess, *supra* note 36, at 96-99. The legislative history of the marriage penalty has led one commentator to suggest that there is insufficient evidence of congressional intent to impose the marriage penalty to warrant application of the sham transaction doctrine to year-end divorces. Note, *The Haitian Vacation*, *supra* note 109, at 1344-48.

¹¹¹ 1980 JOINT COMM. PRINT, *supra* note 3, at 24.

¹¹² Also, the Code's focus upon marital status at year-end does not support the Boyters' position that temporary changes in marital status should be recognized for tax purposes. See Brief for Petitioners at 10, Supplemental Reply Brief for Petitioners at 3, *Boyter v. Commissioner*, 74 T.C. 989 (1980) (copy on file at U.C. Davis Law Review office). Year-end marital status is adopted for purposes of administrative convenience, not to facilitate manipulation of the income tax.

residence, the Tax Court could use state-defined marital status to reach its decision and avoid the more difficult policy considerations involved in the case. If the decrees had contained a finding of domicile in the foreign jurisdiction, it would have been much more difficult for the Tax Court to conclude that Maryland would not recognize the decrees as valid.

Moreover, a small but increasing number of states have determined that domicile is not always a prerequisite to the recognition of a divorce decree rendered in a foreign jurisdiction. If state definitions of marital status are controlling for tax purposes, manipulation of Code provisions would be even easier in these jurisdictions. In *Boyter*, the Tax Court noted that New York has extended recognition to a Mexican divorce proceeding when both spouses participated before the foreign tribunal,¹¹³ but concluded that Maryland would not follow this authority. The Tax Court was apparently not aware of recent authority in Tennessee and Connecticut indicating that domicile of one spouse is not necessary for recognition of a bilateral divorce decree rendered in a foreign country if neither party to the action was prejudiced.¹¹⁴ For example, in *Hyde v. Hyde*,¹¹⁵ Eleanor Hyde traveled to the Dominican Republic in 1974 to obtain a divorce from her husband, Joseph, who was represented by counsel and entered a general appearance in the action. Both of the Hydés were residents of Tennessee at the time of the divorce and obtained the foreign divorce to avoid the extensive delay in obtaining a divorce in their county.¹¹⁶

Two years later, Joseph brought a Tennessee action to obtain a declaratory judgment validating the Dominican Republic decree or, alternatively, a divorce. Eleanor answered by requesting that the divorce be recognized. Thus, both parties supported the decree and neither questioned the jurisdiction of the foreign tribunal. A Tennessee divorce refe-

¹¹³ *Rosenstiel v. Rosenstiel*, 16 N.Y.2d 64, 209 N.E.2d 709, 262 N.Y.S.2d 86 (1965), *cert. denied*, 384 U.S. 971 (1966). The Tax Court declined to consider how a New York court would view the Boyters' divorce. *Boyter*, 74 T.C. at 999 n.13.

¹¹⁴ *Yoder v. Yoder*, 31 Conn. Supp. 345, 330 A.2d 825 (1974) (dictum); *Terrell v. Terrell*, 578 S.W.2d 637 (Tenn. 1979); *Hyde v. Hyde*, 562 S.W.2d 194 (Tenn. 1978). In *Boyter*, the Tax Court stated that only New York extended recognition to foreign divorces if both spouses participated in the proceeding. 74 T.C. at 998-99. However, the Internal Revenue Service acknowledged that Connecticut and the Virgin Islands also recognize a foreign divorce when neither spouse was domiciled in the foreign jurisdiction. Brief for Respondent at 17, *Boyter v. Commissioner*, 74 T.C. 989 (1980) (copy on file at U.C. Davis Law Review office).

¹¹⁵ 562 S.W.2d 194 (Tenn. 1978).

¹¹⁶ *Id.* at 195.

ree, however, entered the action to contest the decree's validity.¹¹⁷

The Tennessee Supreme Court granted comity to the divorce, concluding that the grounds upon which the decree was granted were not offensive to Tennessee's public policies. Regarding the absence of Dominican Republic domicile by either party, the court weighed the state's traditional interest in the marital status of its domiciles against its interest in permitting an exit from broken relationships. The court concluded that comity should be extended to the decree.¹¹⁸ The Tennessee Supreme Court has also recognized a bilateral Haitian divorce decree which contained no provision for alimony to prevent the wife from later pursuing a state court action in Tennessee for alimony.¹¹⁹

If the Boyters had traveled to another state, rather than to a foreign country, and obtained a bilateral divorce, their chances for a successful divorce would have been greatly improved. In *Sherrer v. Sherrer*,¹²⁰ the Supreme Court required Massachusetts to extend full faith and credit to a Florida divorce decree which found Margaret Sherrer to be a Florida resident. Margaret's husband, Edward, had been a party to the Florida action but had not challenged the jurisdictional issue of Margaret's domicile in that forum. Later, Edward instituted a Massachusetts action to have the Florida decree declared invalid. The Court concluded that the requirements of full faith and credit barred Edward from collaterally attacking the Florida decree on jurisdictional grounds in another state after having had a full opportunity to contest the jurisdictional issue.¹²¹ Subsequently, in *Johnson v. Muelberger*,¹²² the Supreme Court extended *Sherrer* to preclude collateral attack of the divorce decree by individuals not parties to the divorce action.

If the Boyters resided in a state which adopted the Tennessee or New York approach with respect to divorce decrees rendered in foreign jurisdictions, or if one of the Boyters had fulfilled the residency requirements for divorce in another state prior to obtaining a bilateral divorce, the Tax Court would have had difficulty concluding they were still married. Perhaps a court might conclude that the Boyters' plan to remarry distinguishes cases such as *Hyde*, since a state has no interest in permitting an easy exit from an ongoing relationship. But the likeli-

¹¹⁷ *Id.*

¹¹⁸ *Id.* at 197-98.

¹¹⁹ *Terrell v. Terrell*, 578 S.W.2d 637 (Tenn. 1979).

¹²⁰ 334 U.S. 343 (1948).

¹²¹ *Id.* at 351.

¹²² 340 U.S. 581 (1951) (daughter by her father's first marriage could not contest the validity of her father's Florida divorce from his second wife on jurisdictional grounds to prevent his third wife from electing to take a statutory share of his estate).

hood of a taxpayer victory would be increased significantly if the court was bound by state law concepts of marriage. Strict adherence to state-defined marital status will increase the potential for manipulation of the Code and compromise tax policy. New federal standards must be adopted to replace or reinforce state-defined marital status as a tax factor. Until new standards are adopted, courts must use flexible analytical approaches when determining a taxpayer's marital status.

D. Sham Transaction Doctrine

Undoubtedly anticipating the weaknesses of state-defined marital status, the Service uses the sham transaction doctrine in Revenue Ruling 76-255 to avoid giving tax effect to a valid divorce. Likewise, the Fourth Circuit made it clear that sham analysis may be used to disregard a valid divorce followed by remarriage. However, the Service's sham theory in Revenue Ruling 76-255 has been criticized by commentators.¹²³ Transactions are generally disregarded as shams when a court concludes that they possess no appreciable economic substance beyond their tax consequences.¹²⁴ For example, taxpayers have been denied interest deductions when a court concluded that the loan did not have "purpose, substance, or utility apart from [its] anticipated tax consequences."¹²⁵ Under this standard, if a valid year-end divorce was accompanied by significant nontax effects, it should be immune from attack as a sham.

In *Boyter* the nontax effects of the divorces appear to be quite significant. The Boyters were divorced for 32 days in 1975-76, and for 79 days in 1976-77. As a consequence of their divorces, the Boyters argued they forfeited claims to survivor annuities under the federal civil service system, lost potential estate tax benefits during the period they were

¹²³ See, e.g., Feld, *Divorce, Tax Style*, 54 TAXES 608 (1976); Note, *The Haitian Vacation*, *supra* note 109. The sham argument, as articulated by the Internal Revenue Service in *Boyter*, was really a combination of the substance-over-form doctrine, the business purpose doctrine, and the step transaction doctrine. Brief for Respondent at 30-42, *Boyter v. Commissioner*, 74 T.C. 989 (1980) (copy on file at U.C. Davis Law Review office).

¹²⁴ *Knetsch v. United States*, 364 U.S. 361, 365-66 (1960) (taxpayer was not allowed to deduct interest paid at a 3.5% rate on nonrecourse loans secured by 2.5% deferred annuity bonds; taxpayer would prepay interest and immediately borrow cash or loan values created by interest payments). Judge Widener, dissenting in the Fourth Circuit's *Boyter* opinion, found it remarkable that the majority did not discuss *Knetsch* in its opinion. 668 F.2d at 1389 (Widener, J., dissenting).

¹²⁵ *Goldstein v. Commissioner*, 364 F.2d 734, 740 (2d Cir. 1966), *cert. denied*, 385 U.S. 1005 (1967).

unmarried, altered the ownership of marital property, and destroyed various legal rights available to married couples under state law.¹²⁶ Thus, if the divorces were valid under state law, there is a serious question whether they could be classified as shams, since they would be accompanied by significant nontax consequences.

Moreover, Judge Widener, dissenting in the Fourth Circuit's decision in *Boyter*, disagreed with the majority's analysis of the sham issue. Noting that the issue was one of first impression, the Judge questioned whether a valid state law divorce could be labeled a sham for tax purposes.¹²⁷ The Judge based his dissent upon an earlier decision by the Fourth Circuit applying sham transaction analysis:

If there is, under the realities of the terms of the transaction, some reasonable hope of the transaction appreciably affecting the taxpayers' beneficial interest other than by a tax reduction, the transaction would not be a sham for tax purposes. Furthermore, if there is, under the realities of the terms of the transaction, some real risk of loss to the taxpayer, other than whatever loss might be actually built in (as it was in the instant [*Bridges*] case), the transaction would not be a sham for tax purposes.¹²⁸

Judge Widener concluded that the determinative tax question, whether "what was done, apart from the tax motive, was the thing the statute intended," could only be answered after determining the validity of the divorces.¹²⁹ Despite the Fourth Circuit's assertion to the contrary, there remains a serious question whether a divorce valid under state law may be considered a sham and disregarded for tax purposes.

Even if tax-motivated divorces may be disregarded as shams, administrative considerations mandate a more certain approach. Marital status affects many tax provisions and should be easily determined. Taxpayers and the government should be able to ascertain matters such as filing status, applicable rate schedule and operation of provisions which depend upon marital status without having to consider questions of intent and purpose or measuring the nontax effects of short-lived divorces. Sham analysis may be appropriate to prevent subversion of tax policy in particular cases, but it is not appropriate as a solution to the broader problems represented by Revenue Ruling 76-255 and *Boyter*. New federal standards should be designed to replace or reinforce state-

¹²⁶ Brief for Petitioner at 19-24, *Boyter v. Commissioner*, 74 T.C. 989 (1980) (copy on file at U.C. Davis Law Review office).

¹²⁷ 668 F.2d at 1388 (Widener, J., dissenting).

¹²⁸ *Id.* at 1389 (citations omitted). The quotation is from *Bridges v. Commissioner*, 325 F.2d 180, 184-85 (4th Cir. 1963) (deduction for interest paid on loans secured by treasury notes disallowed; taxpayer could not expect a profit absent tax deduction).

¹²⁹ 668 F.2d at 1389 (Widener, J., dissenting).

defined marital status as an operative tax factor. These new standards must be tailored to promote tax policy, prevent manipulation, and be definite enough to be efficiently administered.

Revenue Ruling 76-255, *Boyer*, and Private Ruling 7835076 indicate the increasing weakness of state-defined marital status as an operative tax factor. Revenue Ruling 76-255 and *Boyer* demonstrate that a group of taxpayers, albeit small, is willing to engage in year-end shifts in marital status to obtain tax benefits. These strategies may be successful if state definitions of marriage are determinative for tax purposes. Private Ruling 7835076 carries an even more disturbing message. It presents a couple willing to permanently alter their marital status to obtain tax advantages. Neither trend is desirable. Alteration of marital status for tax purposes adversely impacts both the tax law and marriage, and mandates a shift in marriage's role in the income tax. In the section which follows, this Article will detail possible approaches for change.

IV. THE TAX FUTURE OF STATE-DEFINED MARITAL STATUS

The increasing weakness of marital status as an operative tax factor presents serious issues for the income tax. Marriage's role in the Code is undercut to the extent the status is manipulated and loses meaning. Long-term adjustments in the relationship between the tax law and state-defined marital status will occur if present trends continue. To the extent tax provisions are compromised, the importance of local law concepts of marriage in the income tax must be reduced.

As a matter of long-term tax policy, marriage's role in the tax law could be reduced in two different ways. Marital status could be abandoned and replaced with expanded and more flexible standards designed to identify economic relationships similar to traditional marriage. A less drastic approach would be to identify quasi-marital relationships and tax the individuals as if they were married.¹³⁰ Alternatively, the income tax could focus more closely upon the individual taxpayer by eliminating the Code's emphasis upon marital status as a taxing factor.¹³¹ These options rekindle debate about the extent to which personal economic relationships should affect an individual's tax liability.

Since 1948, the income tax has viewed a married couple as a single

¹³⁰ See *infra* text accompanying notes 133-43.

¹³¹ Professor Gann and others have argued for marriage neutrality because of the similarity between marriage and other relationships. See Gann, *supra* note 35, at 25-26.

economic unit for purposes of assessing tax liability. Various other provisions have also treated married taxpayers as a single taxpaying entity. Movement from the present structure will renew theoretical debate concerning the appropriate taxable unit with several significant variations. The first problem for those advocating recognition of sharing relationships outside of marriage will be to obtain agreement upon the nature of the standard to replace marriage. What would be the boundaries of any new classification? For example, would the standard be limited to two person groups or would sharing arrangements in larger groups be recognized for tax purposes? Would same-sex couples, who have historically not been permitted to marry,¹³² be included within the new definition? How long would a sharing relationship have to exist before being recognized for tax purposes?

Professor Wolk has suggested one possible approach for identifying sharing relationships similar to marriage. He advocates recognition of "domestic partnerships" — relationships sufficiently marital in nature to be recognized for tax purposes.¹³³ Professor Wolk suggests that a domestic partnership be defined in terms of the elements proposed by Folberg and Buren as a basis for determining property settlements between unmarried couples:

- I. An actual family relationship, evidenced by (A) cohabiting adults, and (B) the acknowledgement and acceptance of mutual rights, duties, and obligations toward one another;
- II. An ostensible family relationship, demonstrated by evidence that others perceive, or had reason to perceive, the parties' relationship as familial; and
- III. A durable, family relationship evidenced by a domestic union which was in existence for a substantial period of cohabitation.¹³⁴

Professor Wolk also suggests that recognition be limited to domestic partnerships in existence for a substantial period of time, such as three years, and that the domestic partnership concept include same-sex couples.¹³⁵

The social security laws provide an alternative standard for identifying quasi-marital relationships. Certain nonmarital relationships are

¹³² See, e.g., *Jones v. Hallahan*, 501 S.W.2d 588 (Ky. App. 1973) (a relationship between two female persons is not a "marriage" so that issuance of a marriage license is not authorized); *Singer v. Hara*, 11 Wash. App. 247, 522 P.2d 1187 (1974) (state statutes required and state and federal constitutions permitted denial of a marriage license to two male applicants).

¹³³ Wolk, *supra* note 16, at 1267-68.

¹³⁴ *Id.* at 1268.

¹³⁵ *Id.* at 1268-69.

recognized for determining eligibility and benefits under the federal program providing supplemental security income for aged, blind, and disabled individuals.¹³⁶ These provisions provide an approach which could be adapted to federal tax law. Even though state law generally determines marital status, a man and a woman are deemed married for purposes of supplemental security income if they "are found to be holding themselves out to the community in which they reside as husband and wife."¹³⁷ Indicia bearing upon this question include: (1) the names the individuals use; (2) whether the individuals introduce one another as husband and wife; (3) who owns or rents the place where the couple lives; and (4) whether documents such as deeds, leases, time payment papers and tax records show the parties as husband and wife.¹³⁸ Couples considered married under this standard are deemed divorced after they have lived apart for six full months.¹³⁹

While not a complete solution to the problem, tax recognition of nonmarital relationships constituting domestic partnerships or in which the parties hold themselves out as married would end disparate treatment of this group of essentially marital relationships. It would also help reduce manipulation of marital status to obtain tax benefits, since a shift in marital status which is not accompanied by an objective manifestation of some change in the relationship would not alter the couples' tax results. Married taxpayers, contemplating a divorce for tax savings, would have to take steps to alter the public perception of their relationship in addition to obtaining a state law divorce. The taxpayers in Private Ruling 7835076 might have to use different names, change the ownership of their property, and publicly acknowledge their new status to be considered single for tax purposes. Taxpayers may be reluctant to pursue this strategy since it requires significant changes in the nature of their relationship.

However, if a standard replacing marriage or identifying quasi-marital relationships could muster a consensus, serious problems would nev-

¹³⁶ 42 U.S.C. § 1382c(d)(2) (1976).

¹³⁷ *Id.* Being married can reduce the couple's total benefits if they are both "eligible spouses." 42 U.S.C. §§ 1382(b), 1382c(b) (1976). Certain "deemed marriages" are also recognized under the old age, survivors, and disability insurance provisions. Generally, applicants are deemed to be married if they live together and can establish that they went through a marriage ceremony in good faith which would have been valid, but for an unknown legal impediment. 42 U.S.C. §§ 416(h)(1)(B), 1382c(d)(1) (1976).

¹³⁸ 20 C.F.R. § 416.1826(c) (1983). The same regulation creates a presumption that couples living together will be considered married unless they demonstrate they do not lead people to believe they are husband and wife.

¹³⁹ 20 C.F.R. § 416.1832(d) (1983).

ertheless remain. Any standard replacing or supporting marriage as an indicator of economic circumstance must be administrable with relative ease and a high degree of effectiveness. This is a difficult burden to satisfy. A new standard would, like marriage, produce tax benefits on some occasions and result in tax penalties in others. For example, a joint return might reduce the total taxes of the members of a domestic partnership in one year, while filing separate returns as single individuals would save taxes in a different year. Administration of the tax structure would require identification of economic sharing relationships in both situations. This would be an extremely difficult task without an intrusive investigation into the couples' personal living arrangement. Tax recognition of quasi-marital relationships will require a substantial and likely intolerable administrative presence, or result in increased manipulation of tax provisions.

Advocates of limited recognition of cohabitation relationships have acknowledged these administrative difficulties.¹⁴⁰ In urging recognition of domestic partnerships for tax purposes, Professor Wolk argues that similar administrative difficulties exist regarding common law marriages, yet they are recognized by the tax law.¹⁴¹ However, the strength of this argument depends, at least in part, upon the potential number of domestic partnerships recognized for tax purposes. If the number of domestic partnerships were large in comparison to the number of common law marriages, the administrative burden would be significantly increased. Professor Wolk also leaves open the possibility that domestic partnerships could be recognized for purposes of excluding wealth transfers between cohabitants from gross income and ignored for determining filing status.¹⁴² This approach would greatly reduce administrative concerns but would not be responsive to the problems represented by *Boyer*, since year-end marital status could still be manipulated to obtain tax advantages.¹⁴³ Thus, given the potential difficulty in creating and administering replacement or supportive standards for marriage, movement toward a more marriage-neutral income tax seems the most likely long-term structural response if present trends regarding marriage continue.

Movement toward marriage neutrality would revive the issue of whether community property laws should be given effect for tax pur-

¹⁴⁰ Wolk, *supra* note 16, at 1270-71, 1274-75.

¹⁴¹ *Id.* at 1270-71.

¹⁴² *Id.* at 1274-75.

¹⁴³ Professor Wolk recognizes that manipulation by unmarried cohabitants is a possible result of recognizing domestic partnerships for tax filing purposes. *Id.*

poses. Congress, when it addressed the marriage penalty in the Economic Recovery Tax Act of 1981, chose to disregard the effect of community property laws. The deduction available for two-earner married couples is computed on a base which is essentially equal to the lower earning spouse's earned income determined without reference to community property laws.¹⁴⁴ This approach is proper in view of *Boyter* and trends concerning marriage. If community property laws respecting earned income are given effect for tax purposes, state-defined marital status would retain a good deal of significance, even in an ostensibly marriage-neutral tax system. Married couples in a community property state would again reap the benefits of income splitting with respect to salaries and wages and year-end marriages by single taxpayers would be an effective tax saving strategy.

Community property laws concerning income from property could be given effect in a tax structure responding to the weaknesses of state-defined marriage. Income from property can be shifted between unmarried taxpayers through transfers of the underlying property.¹⁴⁵ Therefore, shifts in marital status would not provide benefits different from those currently available to all taxpayers willing to alter the ownership of property.

Despite the trends concerning marriage, fundamental shifts in the relationship between the tax law and marriage are not likely to occur in the near future. Marriage's continuing viability as an institution makes rapid change doubtful. Broad based responses to the problems posed by Revenue Ruling 76-255, *Boyter*, and Private Ruling 7835076 must be tailored to long-term developments, which militates against an immediate major revision in marriage's role in the income tax. Some state courts have rejected legal trends blurring the nature of marital and nonmarital relationships.¹⁴⁶ Also, the lack of litigated cases involving year-end divorces indicates that the vast majority of taxpayers do not attempt these strategies. Instead of major revision, the most likely responses to the weaknesses of state-defined marital status will be enactment of legislation designed to reduce the tax significance of local

¹⁴⁴ I.R.C. § 221(b)(1).

¹⁴⁵ See, e.g., *Blair v. Commissioner*, 300 U.S. 5, 12 (1937) (assignments of portions of the beneficial interest in a trust were effective to shift taxation of the related income); *FEDERAL TAXATION*, *supra* note 11, at ¶ 75.3.

¹⁴⁶ E.g., *Hewitt v. Hewitt*, 77 Ill. 2d 49, 394 N.E.2d 1204, 1207 (1979) (claim brought by cohabitant for an equal share of profits and properties accumulated during the relationship was contrary to public policy and unenforceable); see also *Rehak v. Mathis*, 239 Ga. 541, 543, 238 S.E.2d 81, 82 (1977) (cohabitation constitutes immoral consideration and will not support a claim for equitable relief).

law definitions of marriage and adoption by courts of policy-based approaches to analyze tax-motivated divorces.

A. Legislative Responses to the Weaknesses of State-Defined Marital Status

Legislative responses to the problems posed by current trends concerning marriage will likely come in two forms: (1) particular Code provisions will be modified as taxpayers attempt tax-motivated divorces to reap tax benefits or marriage-based tax distinctions are perceived to be inequitable; and (2) state-defined marital status will be reinforced by federal standards as an operative tax factor.

The recent change concerning the marriage penalty is an example of the first form of response. Congress adjusted the tax burden of two-earner married couples relative to one-earner couples and single taxpayers. Future additional changes are therefore probable. One would hope this legislative effort is indicative of increased sensitivity to disparate treatment of various taxpaying units. A pattern of intermittent change in various Code provisions is a likely response to the weaknesses of state-defined marital status.

State-defined marital status should also be reinforced by federal standards to reduce the likelihood of manipulation. Congress should adopt new federal standards which would reduce the importance of year-end marital status. One fairly simple solution would be to determine tax marital status based upon marital status for a majority of the year, rather than at year-end. Taxpayers married for six months or less would be deemed to be single while those married over one-half of the year would be considered married. Under this approach, the Boyters would have been considered married for tax purposes despite valid year-end divorces. Alternatively, divorces followed by remarriage within some established period of time could be disregarded for tax purposes. This solution is more directly addressed to tax-motivated divorces since year-end marital status would continue to be determinative for the vast majority of taxpayers.¹⁴⁷

Divorces following marriages lasting less than some reasonable period, such as one year, could also be accorded special status within the Code. Recognition could be denied to such divorces for the purpose of applying the income splitting provisions of sections 71 and 215. This approach would be similar to the Code's wash sales provision, which

¹⁴⁷ One writer has suggested nullifying for tax purposes a divorce and remarriage between the same individuals. Feld, *supra* note 123, at 612.

disallows losses from the sale of a security if the taxpayer purchases the same security within a certain time period.¹⁴⁸ The loss is disregarded because the related sale leaves the taxpayer's investment in the security undisturbed. Similarly, marriages or divorces of very short duration could be ignored and treated as not disturbing the taxpayer's original marital status.

There is precedent supporting adoption of federal statutory standards for marital status. For purposes of federal old age, survivors, and disability insurance benefits, marital status is generally determined under state law.¹⁴⁹ However, the terms "wife" and "husband" are defined so as to disregard, in certain situations, marriages lasting less than one year.¹⁵⁰ Also, the terms "divorced wife," "widow," and "widower" are defined to include duration-of-relationship requirements.¹⁵¹ These re-

¹⁴⁸ I.R.C. § 1091.

¹⁴⁹ 42 U.S.C. § 416(h)(1)(A) (1976).

¹⁵⁰ 42 U.S.C. § 416(b), (f) (Supp. V 1981). Section 416(b) defines "wife":

The term "wife" means the wife of an individual, but only if she (1) is the mother of his son or daughter, (2) was married to him for a period of not less than one year immediately preceding the day on which her application is filed, or (3) in the month prior to the month of her marriage to him (A) was entitled to, or on application therefor and attainment of age 62 in such prior month would have been entitled to, benefits under subsection (b), (e), or (h) of section 402 of this title, (B) had attained age eighteen and was entitled to, or on application therefor would have been entitled to, benefits under subsection (d) of such section (subject, however, to section 402(s) of this title), or (C) was entitled to, or upon application therefor and attainment of the required age (if any) would have been entitled to, a widow's, child's (after attainment of age 18), or parent's insurance annuity under section 231a of title 45. For purposes of clause (2), a wife shall be deemed to have been married to an individual for a period of one year throughout the month in which occurs the first anniversary of her marriage to such individual. For purposes of subparagraph (C) of section 402(b)(1) of this title, a divorced wife shall be deemed not to be married throughout the month in which she becomes divorced.

A similar definition of "husband" is contained in 42 U.S.C. § 416(f).

¹⁵¹ 42 U.S.C. § 416(d)(1), (c), (g) (Supp. V 1981). Some of these duration-of-relationship standards are incorporated into the Railroad Retirement Act of 1974. 45 U.S.C. § 231a(d) (1976 & Supp. V 1981). The nine-month marriage requirement in the definitions of "widow" and "widower" in § 416 is waived if the spouse dies accidentally or in the line of duty in the armed services. The durational requirement is also waived if the widow or widower was previously married to the individual and subsequently divorced and the nine-month requirement would have been satisfied if the prior marriage had been terminated by death. 42 U.S.C. § 416(k) (1976). In *Weinberger v. Salfi*, 422 U.S. 749 (1975), the Supreme Court upheld the nine-month durational requirement against constitutional challenge.

quirements are designed to prevent abuses of the program and promote efficient administration. In affirming the constitutionality of these types of provisions, the Supreme Court recognized the potential benefits of federal standards regarding marital status:

[T]he duration-of-relationship requirement represents not merely a substantive policy determination that benefits should be awarded only on the basis of genuine marital relationships, but also a substantive policy determination that limited resources would not be well spent in making individual determinations. It is an expression of Congress' policy choice that the Social Security system, and its millions of beneficiaries, would be best served by a prophylactic rule which bars claims arising from the bulk of sham marriages which are actually entered, which discourages such marriages from ever taking place, and which is also objective and easily administered.¹⁵²

Similarly, for deportation purposes, a marriage is ignored if it is entered into less than two years prior to entry of the alien and is judicially annulled or terminated within two years subsequent to entry, unless the alien establishes that the marriage was not for the purpose of evading the immigration laws.¹⁵³ In each of these situations, local law concepts of marriage have been reinforced by federal standards to prevent manipulation of marital status and promote the effective operation of the statute. The increasing weakness of state-defined marital status as an operative tax factor requires that similar provisions be enacted as part of the Internal Revenue Code.

These approaches are not, however, responsive to the problems represented by Private Ruling 7835076. Married taxpayers willing to permanently alter their marital status would be single individuals for tax purposes. A special standard could be adopted to test divorces to see if they represent a real change in the parties' relationship, but that would result in different treatment of cohabitants depending solely upon whether they were previously married. Taxpayers who live together and have never been married would be considered single while taxpayers in the same situation would be deemed married because of their previous marriage. This difference is too tenuous to base tax distinctions upon so long as marriage remains the operative tax factor in the Internal Revenue Code. Complete elimination of the marriage penalty, adoption of a replacement or supportive standard for marriage, or movement toward a marriage-neutral income tax is needed to eliminate the incentive for divorce in Private Ruling 7835076.

¹⁵² Weinberger v. Salfi, 422 U.S. 749, 784-85 (1975).

¹⁵³ 8 U.S.C. § 1251(c) (1976).

B. Judicial Responses to Tax-Motivated Divorces

In the absence of legislation dealing with shifts in marital status, the courts must be willing to introduce a greater degree of flexibility into the process of determining tax marital status. As demonstrated, rigid adherence to local law determinations of marital status must give way to prevent manipulation of Code provisions. In view of the potential weakness in the sham analysis,¹⁵⁴ new approaches which focus upon tax policy must be devised by the courts.

Precedent exists to support this approach. Controversies have arisen over the effect of an annulment or an invalid divorce upon tax marital status.¹⁵⁵ In the majority of these situations, the courts and the Internal Revenue Service have had to decide the tax effect of a marriage subsequently determined to be defective and, therefore, invalid. Not surprisingly, precedent is inconsistent in both approach and result.¹⁵⁶ A review of this authority indicates principles which could be used in dealing with tax-motivated divorces.

The Service and a majority of courts considering the effect of an annulment or divorce decree upon tax marital status have focused upon the local law effect of the decree; if the decree is effective under state law it will be effective for tax purposes.¹⁵⁷ For example, in Revenue

¹⁵⁴ See *supra* text accompanying notes 123-29.

¹⁵⁵ E.g., *Estate of Borax v. Commissioner*, 349 F.2d 666 (2d Cir. 1965) (considering the consequences of a Mexican divorce declared invalid by a New York court), *cert. denied*, 383 U.S. 935 (1966); *Lee v. Commissioner*, 64 T.C. 552 (1975) (considering the tax effects of a Mexican divorce treated as a nullity by the parties), *aff'd per curiam*, 550 F.2d 1201 (9th Cir. 1977); *Newburger v. Commissioner*, 61 T.C. 457 (1974) (determining the tax effects of an annulment), *acq.* 1974-2 C.B. 3; Rev. Rul. 76-255, 1976-1 C.B. 40 (situation 1: determining the filing status of a couple whose marriage was annulled under a decree declaring that no valid marriage ever existed); Rev. Rul. 67-442, 1967-2 C.B. 65 (setting forth the Service's position regarding divorces subsequently declared invalid).

¹⁵⁶ Compare *Estate of Borax v. Commissioner*, 349 F.2d 666 (2d Cir. 1965) (Mexican divorce, declared invalid by a New York court, was recognized for tax purposes), *cert. denied*, 383 U.S. 935 (1966) with *Lee v. Commissioner*, 64 T.C. 552 (1975) (Mexican divorce, which was not recognized under California law, did not terminate the husband's marriage to his first wife so he and his second wife were not married and could not file a joint return), *aff'd per curiam*, 550 F.2d 1201 (9th Cir. 1977).

¹⁵⁷ Controversy has surrounded the treatment of interlocutory divorce decrees. For example, in *Eccles v. Commissioner*, 19 T.C. 1049, *aff'd per curiam*, 208 F.2d 796 (4th Cir. 1953), the state court issued an interlocutory divorce decree on August 2, 1949 which was to become absolute six months later. The issue in the case was whether the taxpayers could file a joint return in 1949. Looking to local law, the Tax Court determined that the interlocutory decree did not operate as a decree of divorce or separate maintenance and, therefore, the parties remained married for tax purposes

Ruling 76-255,¹⁵⁸ the Service considered the tax effect of a 1976 decree annulling a 1975 marriage and concluded that since a valid marriage never existed, the individuals were, at all times, single for tax purposes.

Courts have adopted a similar analytical approach when considering the effect of migratory divorces subsequently declared invalid.¹⁵⁹ In *Un-*

during 1949. The Internal Revenue Service initially refused to follow *Eccles. Rev. Rul. 55-178, 1955-1 C.B. 322*. After again litigating and losing on the issue in *Commissioner v. Ostler, 237 F.2d 501 (9th Cir. 1956)*, the Service agreed to change its position and to follow *Eccles. Rev. Rul. 57-368, 1957-2 C.B. 896*. However, an appeal from a final decree of divorce will generally not permit the taxpayers to file jointly pending the outcome of the appeal. See *Sullivan v. Commissioner, 29 T.C. 71 (1957), aff'd, 256 F.2d 664 (4th Cir. 1958)*.

Wisconsin law presents a variation of these questions. In Wisconsin, it is unlawful for a person who has been a party to a divorce action to marry again within six months after the judgment of divorce is granted. The divorce is effective immediately, subject to the court's power to vacate or modify the judgment upon its own motion or at the request of both of the parties during the six-month period. In *Rev. Rul. 79-330, 1979-2 C.B. 391*, the Service held that since the judgment is a final decree, a husband and wife divorced under Wisconsin law cannot file jointly for a taxable year ending within the six-month period.

¹⁵⁸ 1976-2 C.B. 40 (situation 1).

¹⁵⁹ The issue generally arises when the invalidating jurisdiction is different from the jurisdiction that granted the divorce decree. If the jurisdiction that granted the divorce declares the divorce invalid, the divorce is not recognized for tax purposes. *Estate of Buckley v. Commissioner, 37 T.C. 664 (1962)*.

The Internal Revenue Service, in an effort to protect the federal fisc, has followed a path which allows it the greatest flexibility when dealing with invalidated divorces. In *G.C.M. 25250, 1947-2 C.B. 32*, the Service examined the tax consequences of a Mexican divorce which, it was concluded, would not be recognized under state law. The memorandum held that since the parties had obtained the divorce in good faith and there was no tax avoidance motive, the Mexican decree would be recognized for purposes of the Code's alimony provisions.

G.C.M. 25250 was reexamined in *Rev. Rul. 57-113, 1957-1 C.B. 106*. In that ruling, a husband obtained a Mexican divorce and, immediately thereafter, his former wife brought a state court action contesting the validity of the Mexican divorce, requesting a legal separation, and asking for a support allowance pending the outcome of the suit. Support was granted and the ruling's issue was whether the husband was entitled to deduct those payments. The payments were deductible only if the prior divorce was invalid. Otherwise the marital relationship would have been previously terminated and the payments would not satisfy the statutory requirement that they be made while the parties are separated and pursuant to a decree. The Service held that the payments were deductible, distinguishing *G.C.M. 25250* by focusing upon the subsequent state decree. The Service concluded that *G.C.M. 25250* "was not intended to recognize the Mexican decree over subsequent decrees in other jurisdictions." 1957-1 C.B. at 107.

In *Rev. Rul. 67-442, 1967-2 C.B. 65*, the Service considered facts similar to *Estate of Borax v. Commissioner, 349 F.2d 666 (2d Cir. 1965)* (husband's Mexican divorce from

termann v. Commissioner,¹⁶⁰ Sally Cheney obtained a Nevada divorce from her first husband by substituted service of process and immediately married John Untermann. Sally and John lived in New Jersey until 1953, when John obtained a divorce decree from Sally in Juarez, Mexico. Shortly thereafter, John married Sarah Kaltman in Connecticut and they returned to New Jersey to live.

Sally, after learning of the Mexican decree, began proceedings to establish her status as John's legal wife. John answered the complaint by

his first wife declared invalid by a New York court; however, the Second Circuit adopted a rule of validation to recognize the Mexican divorce for tax purposes and permit the husband to deduct support payments to his first wife and treat the husband and his second wife as married), *cert. denied*, 383 U.S. 935 (1966). See *infra* text accompanying notes 163-68. Declining to follow *Borax*, the ruling, without explanation, states the Service's position with respect to invalid divorce decrees:

The Internal Revenue Service *generally* will not question for Federal income tax purposes the validity of any divorce decree until a court of competent jurisdiction declares the divorce to be invalid. However, where a state court, in a proceeding in which there is personal jurisdiction of the parties or jurisdiction of the subject matter of the action, declares the prior divorce to be invalid, the Service will *usually* follow the later court decision rather than the divorce decree for Federal income tax purposes . . .

1967-2 C.B. at 66 (emphasis added).

Revenue Ruling 67-442 states that it is a clarification of G.C.M. 25250, but it is apparent that the Service has abandoned views set forth in the earlier pronouncement. See Spolter, *Invalid Divorce Decrees*, 24 TAX L. REV. 163, 174-75 (1969). The Service has challenged divorces which had not been invalidated and were effected in good faith and not for tax avoidance, when the revenues were endangered. See *Gersten v. Commissioner*, 267 F.2d 195 (9th Cir. 1959) (Mexican divorce never declared invalid challenged to prevent husband and second wife from filing a joint return). If good faith and tax motivation were the controlling standards, there should be no objection to the result in *Borax*; Herman Borax relied in good faith upon the Mexican divorce to subsequently marry Hermine and the divorce was not undertaken to reap tax benefits. The Service's fixation upon the existence of an invalidating decree is also odd in view of the fact that the Mexican divorce in G.C.M. 25250 was determined to be invalid under controlling state law. There is no theoretical basis for treating an admittedly invalid divorce in a different fashion depending upon the existence of a subsequent invalidating decree.

The Service's position in Revenue Ruling 67-442 is best explained in terms of administrative considerations. In the vast majority of situations, the Service does not have to concern itself with issues relating to marital status; the existence of a divorce decree is determinative. Yet, at the same time, the Service retains sufficient flexibility to deal with tax-motivated shifts in marital status. The ruling's stance is also in accord with the fundamentally sound principle that Congress intended state law to control determinations of marital status. When conflicts arise over marital status, state law should be controlling to the extent tax principles are not undermined.

¹⁶⁰ 38 T.C. 93 (1962).

charging that Sally's Nevada divorce from her first husband was invalid, which rendered their marriage void. In the state court proceedings, Sally's complaint was dismissed under the doctrine of unclean hands. The court determined that John's Mexican divorce was invalid but did not invalidate Sally's earlier Nevada divorce, although the court questioned its validity on jurisdictional grounds.

The issue before the Tax Court was whether John could file a joint return with Sarah and claim an exemption for her. The court analyzed the state law effect of these events and concluded that New Jersey, the state of the parties' domicile, continued to recognize the validity of John's marriage to Sally. Thus, his subsequent marriage to Sarah was void, which precluded John and Sarah from filing jointly and John from claiming an exemption for Sarah.¹⁶¹

Some courts have been more flexible when an identifiable tax policy is jeopardized.¹⁶² In particular, courts have been willing to abandon state-defined marital status to further the policies underlying the Code's alimony provisions. In *Estate of Borax v. Commissioner*,¹⁶³ the Second Circuit articulated a rule of validation whereby the court would recognize divorce decrees in determining tax marital status despite the subsequent declaration of the decree's invalidity by another jurisdiction. In *Borax*, Herman and Ruth Borax were married and had lived together in New York until 1946, when they separated pursuant to a written separation agreement. Six years later, Herman obtained a divorce from Ruth in Chihuahua, Mexico, in a proceeding in which Ruth was not served and did not appear. A short time later, Herman married Hermine and they lived together in New York City.

Ruth later filed an action in New York seeking to be declared Her-

¹⁶¹ *Id.* at 96-97. The court found that John and Sarah living together violated local law, which precluded Sarah from being John's dependent.

¹⁶² *Wondsel v. Commissioner*, 350 F.2d 339 (2d Cir. 1965) (Florida divorce declared invalid by a New York court given effect for tax purposes; husband could deduct payments to his first two wives and file a joint return with his third wife); *Estate of Borax v. Commissioner*, 349 F.2d 666 (2d Cir. 1965) (Mexican divorce declared invalid by a New York court recognized for tax purposes; rule of validation tends to further policy of placing the tax burden of marital settlements upon the recipient), *cert. denied*, 383 U.S. 935 (1966); *Feinberg v. Commissioner*, 198 F.2d 260 (3d Cir. 1952) (Florida divorce declared invalid by a New York court was not a nullity for tax purposes; it is consistent with the general intent of Congress to permit the husband to deduct payments pursuant to a separation decree); *Newburger v. Commissioner*, 61 T.C. 457 (1974) (payments made under a decree declaring a marriage void were deductible alimony; the Code is more concerned with the nature of the payments than with the label of the action under which the payments are made), *acq.* 1974-2 C.B. 2.

¹⁶³ 349 F.2d 666 (2d Cir. 1965), *cert. denied*, 383 U.S. 935 (1966).

man's lawful wife. In that proceeding, the New York court had personal jurisdiction over Herman and Hermine, who were represented by counsel and participated in the suit. The court determined that Ruth was Herman's lawful wife, that Herman and Hermine were not husband and wife, and that the Mexican divorce decree was invalid.

Herman and Hermine's problems had just begun, however. The Internal Revenue Service, relying upon the New York court's determination as to Ruth's status as Herman's wife, asserted deficiencies against Herman and Hermine, taking the position that: (1) Herman's payments to Ruth pursuant to the separation agreement were not deductible since they were not divorced;¹⁶⁴ (2) Herman and Hermine were not entitled to file jointly since they were not married; and (3) Herman was not entitled to claim Hermine's children or parents as dependents.

The Second Circuit first considered the tax consequences of the payments from Herman to Ruth. The court held, for purposes of the relevant federal tax provisions, that Ruth and Herman were divorced; the subsequent declaration of invalidity of the Mexican decree by New York had no tax consequences.¹⁶⁵ The court defended the rule of validation on policy grounds. Recognizing that states may differ in view as to the validity of a divorce decree, the Second Circuit believed its approach promoted certainty and uniformity of tax results.¹⁶⁶ In addition, the court discerned a congressional policy within the Code to place the tax burden of marital settlement payments upon the party obtaining their benefits, a policy the Second Circuit viewed as fostered by the rule of

¹⁶⁴ The years in issue were 1952-55 and 1957. Prior to 1954, payments pursuant to a written separation agreement were not within the Code's alimony provisions. Internal Revenue Code of 1939, ch. 1, §§ 22(k), 23(u), 56 Stat. 816-17 (current version at I.R.C. §§ 71, 215). Herman and Ruth had to be divorced under a decree of divorce in order for Herman to be able to deduct the payments.

¹⁶⁵ The Second Circuit has not limited the rule of validation to divorces obtained in foreign jurisdictions. In *Wondsel v. Commissioner*, 350 F.2d 339 (2d Cir. 1965), Harold Wondsel married May in 1927 in New York. In 1936, they executed a separation agreement and in 1937 Harold obtained an *ex parte* divorce in Florida. Harold later remarried in Connecticut. In 1941, May obtained a New York judgment affirming that she was Harold's wife and declaring the Florida divorce null and void. In 1946, Harold and his second wife separated and Harold again obtained an *ex parte* Florida divorce. Shortly thereafter, Harold moved to New Jersey where he married a third time. The issues before the court were the deductibility of Harold's payments to his first two wives and whether Harold and his third wife could file a joint return in which the wife was claimed as a dependent. The Internal Revenue Service took the position that Harold's first divorce was invalid so he was still married to his first wife and his subsequent marriages and divorces had no tax effect. The Second Circuit, relying on *Estate of Borax*, reversed the Tax Court's decision in favor of the Service.

¹⁶⁶ 349 F.2d at 670.

validation. The court determined that the statutory requirement that marital relationships be dissolved by a judicial decree of divorce or separation does not express any significant tax policy. It found support for its view in the 1954 amendment to the alimony provisions, which extended identical tax treatment to support payments made pursuant to a voluntary written separation agreement. The court reasoned that if a voluntary separation is sufficient to trigger the relevant tax provisions, certainly the same tax treatment should result to a couple such as Ruth and Herman when they cease living together as a marital unit and one of them obtains a divorce decree, albeit invalid.¹⁶⁷

The court went on to hold that Herman and Hermine were married for purposes of filing and dependency exemptions, concluding that if the Mexican divorce was recognized for purposes of characterizing payments made to Ruth, it would be anomalous not to recognize it for the purpose of Herman and Hermine's tax returns as husband and wife.¹⁶⁸ Thus, the court in *Borax* adopted a more expansive interpretation of the concept of divorce which it found consistent with the reality of the situation and the tax law's revenue purposes. The Second Circuit was willing to abandon state-defined marital status in order to promote tax policies which the court viewed as significant.

Courts have also adopted a more flexible approach when dealing with the tax effects of an annulment. Some courts have avoided "becoming mired in the State law distinctions between void and voidable marriages"¹⁶⁹ by disregarding whether the grounds for the annulment arose prior to or after the marriage. Instead, these courts have focused upon the policies underlying sections 71 and 215 and the fact that state law generally provides for support in annulment actions. For example, in *Newburger v. Commissioner*,¹⁷⁰ Barbara had instituted a separation action against Andrew in a New York state court. Andrew counter-

¹⁶⁷ *Id.* at 670-71.

¹⁶⁸ *Id.* at 675-76.

¹⁶⁹ *E.g.*, *Laster v. Commissioner*, 48 T.C. 178, 188 (1967) (periodic payments made by a husband subsequent to a decree of annulment were gross income to the wife under § 71(a)(2) and deductible by him under § 215), *acq.* 1971-2 C.B. 3. In its earliest statements concerning the taxability of amounts paid under an annulment decree, the Service distinguished between causes of action existing at the inception of the marriage and those arising after the marriage. Special Ruling, Dec. 8, 1944, [1945] 4 STAND. FED. TAX REP. (CCH) ¶ 6092; Rev. Rul. 59-130, 1959-1 C.B. 61.

¹⁷⁰ 61 T.C. 457 (1974), *acq.* 1974-2 C.B. 3. Despite its acquiescence in *Newburger*, the Service has held that taxpayers must file amended returns as single persons if a court of competent jurisdiction annuls their marriage in a subsequent taxable year. Rev. Rul. 76-255, 1976-2 C.B. 40 (situation 1).

claimed for annulment based on the invalidity of a prior divorce obtained by Barbara from her first husband. Andrew's counterclaim was successful and his marriage to Barbara was declared void at its inception; thus under state law Barbara and Andrew were never married. In addition, the New York state court ordered Andrew to make support payments to Barbara. The issue before the Tax Court was the tax consequences of those payments.

The Tax Court held, despite the annulment decree, that the periodic payments made by Andrew to Barbara were in recognition of a general legal obligation, arising out of their marital relationship, and were alimony to Barbara within section 71 and deductible by Andrew under section 215.¹⁷¹ The court supported its holding with an examination of New York state law. Since New York did not distinguish between void and voidable marriages for purposes of support, the court felt the distinction should not be made for tax purposes. To do so, the court reasoned, would be to ignore the tax statutes' concern with whether the payments are in the nature of support. Since the putative marriage between Andrew and Barbara was recognized for purposes of creating a legal obligation upon Andrew to support Barbara, the court determined that the relationship should be recognized for tax purposes. Again, the court abandoned minor distinctions over state-defined marital status in an effort to further tax policy.

In the absence of legislative action, courts must be willing to abandon state definitions of marital status when dealing with tax-motivated divorces. The potential for taxpayers to obtain valid year-end divorces and the weaknesses of the sham analysis require adoption of policy-based approaches for the determination of tax marital status in these situations. Courts must, like the courts in *Borax* and *Newburger*, disregard state law definitions of marital status when analyzing tax-motivated divorces. Valid temporary divorces and marriages should be disregarded when recognition would undermine discernable tax policy.

¹⁷¹ *Newburger v. Commissioner*, 61 T.C. at 460; *accord* *Reisman v. Commissioner*, 49 T.C. 570 (1968); *Laster v. Commissioner*, 48 T.C. 178 (1967), *acq.* 1971-2 C.B. 3; *Reighley v. Commissioner*, 17 T.C. 344 (1951); *Williamson v. Commissioner*, 37 T.C.M. 1189 (1978). Barbara was not required to include the payments in income. In *Newburger v. Commissioner*, 33 T.C.M. 219 (1974), the Tax Court held that the Internal Revenue Service could not retroactively change its published position to tax Barbara.

However, the Tax Court would most likely not permit Andrew and Barbara to file a joint return as husband and wife while living together. The court has held that a decree declaring a marriage void precludes the filing of a joint return. *Wilson v. Commissioner*, 35 T.C.M. 1276 (1976); *Chap v. Commissioner*, 23 T.C.M. 132 (1964).

The approach adopted by the *Borax* court has, however, been widely criticized.¹⁷² In *Lee v. Commissioner*,¹⁷³ the Tax Court and the Court of Appeals for the Ninth Circuit rejected application of the rule of validation when determining whether Harold Lee and his second wife could file a joint return. The court concluded that state law is determinative of marital status, and under state law, Harold's Mexican divorce decree from his first wife was a nullity, invalidating his second marriage and preventing the filing of a joint return with his second wife. In refusing to follow *Borax*, the Tax Court reasoned that Congress did not intend tax marital status to vary from state law marital status and stated:

Were we to depart from the clearly demarcated path laid down for us by State law and begin to construct "for-tax-purposes only" marriages and divorces, we would shortly be faced with insoluble conundrums rooted on the reality that marital status is in fact a matter of State law. . . . Until Congress instructs us otherwise, we consider it proper to leave questions of marital status to State law.¹⁷⁴

¹⁷² See *Lee v. Commissioner*, 64 T.C. 552, 557 (1975) (tax court refused to follow *Borax* to the extent it provides that marital status is determined by a "uniform Federal standard rather than by . . . application of State law"), *aff'd per curiam*, 550 F.2d 1201 (9th Cir. 1977); *Estate of Steffke v. Commissioner*, 64 T.C. 530 (1975) (court refused to extend *Borax* to an estate tax situation; if there are conflicting judicial decrees regarding the validity of a divorce, the decision which would control in the state of the estate's administration will be followed), *aff'd*, 538 F.2d 730 (7th Cir.), *cert. denied sub nom. Wisconsin Valley Trust Co. v. Commissioner*, 429 U.S. 1022 (1976); Fried, *External Pressures on Internal Revenue: The Effect of State Court Adjudications In Tax Litigation*, 42 N.Y.U. L. REV. 647, 653-54 (1967) (divorces are not obtained to affect taxes; state court adjudication on the question of status should be binding if the court had jurisdiction of the parties); Spolter, *supra* note 159 (*Borax* court was preoccupied with uniformity of result and did not adequately analyze the policies of the various tax provisions); Note, *Invalidated Divorce Recognized for Federal Tax Purposes*, 18 STAN. L. REV. 750 (1966) (concern over certainty could be satisfied by relying on the invalidating decree, and *Borax* is not consistent with the policies of the joint return privilege). The criticism has not been unanimous. See Note, *Divorce, Conflict of Laws, and the I.R.S.*, *supra* note 57.

Even the Second Circuit has given conflicting signals concerning its commitment to the principles set forth in *Borax*. In *Estate of Spalding v. Commissioner*, 537 F.2d 666 (2d Cir. 1976), the court applied the rule of validation to hold that an individual was a "surviving spouse" for purposes of the estate tax marital deduction. However, shortly after *Spalding*, in *Estate of Goldwater v. Commissioner*, 539 F.2d 878 (2d Cir. 1976), the Second Circuit refused to apply *Borax* in interpreting the marital deduction provision when the decree invalidating a prior divorce came from the state in which the decedent's estate was being administered. For a criticism of *Goldwater*, see Note, *Divorce, Conflict of Laws, and the I.R.S.*, *supra* note 57, at 291-93 (arguing that the *Goldwater* court ignored the rationale of *Borax*).

¹⁷³ 64 T.C. 552 (1975), *aff'd per curiam*, 550 F.2d 1201 (9th Cir. 1977).

¹⁷⁴ 64 T.C. at 558.

Commentators have also found fault with the Second Circuit's analysis in *Borax*. It has been suggested that the court overstated the tax law's interest in Herman and Ruth's marital status since the divorce was not obtained to affect the imposition of a tax.¹⁷⁵ Also, the court's concern for uniformity and certainty has been criticized. It has been asserted that the court was improperly preoccupied with uniformity of result and disregarded the substantive legal consequences attaching to marital status.¹⁷⁶ Worry over certainty has been termed "needless" since New York had invalidated the Mexican divorce decree and certainty could be served by assuming divorces are valid in the absence of an invalidating decree entitled to full faith and credit.¹⁷⁷

Writers have also criticized the *Borax* court's use of tax policy. Tax concerns may mandate recognition of the invalid Mexican divorce for purposes of the alimony provisions, but the Second Circuit did not analyze the tax policies underlying the joint return and dependency provisions with the same depth. It has been suggested that proper analysis would limit the application of the rule of validation to the alimony provisions; thus Herman Borax would be considered married under certain provisions of the Internal Revenue Code and single under others.¹⁷⁸

These arguments are not persuasive in the context of shifts in marital status undertaken for tax purposes. Congress intended state law marital status to be controlling for tax purposes, but this principle does not require recognition of temporary year-end shifts in marital status. In such a situation, the tax law's interest in the parties' marital status is paramount and courts should be willing to adopt analytical approaches which will protect that interest and promote existing tax policy.

CONCLUSION

The assumptions underlying the role of state-defined marital status in the tax law have been eroded. These developments require a reevaluation of the Code's treatment of marriage which extends beyond the historical debate over whether to aggregate the income of married couples. Fundamental changes in the nature of personal relationships should refocus debate in this area and will have substantial long- and short-term impact upon the tax law. Additional attention must be di-

¹⁷⁵ Fried, *supra* note 172, at 653-54.

¹⁷⁶ Spolter, *supra* note 159, at 184-85.

¹⁷⁷ Note, *Invalidated Divorce Recognized for Federal Tax Purposes*, 18 STAN. L. REV. 750, 752-53 (1966).

¹⁷⁸ Spolter, *supra* note 159, at 186-88.

rected to distinctions in the Code based upon marital status, and federal definitions of marital status for tax purposes should be adopted. In the absence of legislative action, the Service and the courts must act to prevent manipulation of marriage-based tax distinctions and to promote tax policy.

